4. Trading Realities

Chapter 1: Introduction

If you are new to trading and you still have capital, let me start with the biggest mistake you can make. If your win rate is less than 75%, trim your size to 1 share until you reach that level for a few months. Trading is not easy and anyone who tells you otherwise is a liar. Learning how to trade takes time and until you master it you want to keep your “tuition” low.

In this section we will discuss some of the realities of trading. Here are a few of the topics: under capitalization, not keeping a trade log, following someone else’s trades, oversizing, unrealistic expectations, no game plan and over confidence. The list of topics is long.

In this section you’ll learn the trials and tribulations of becoming a trader.

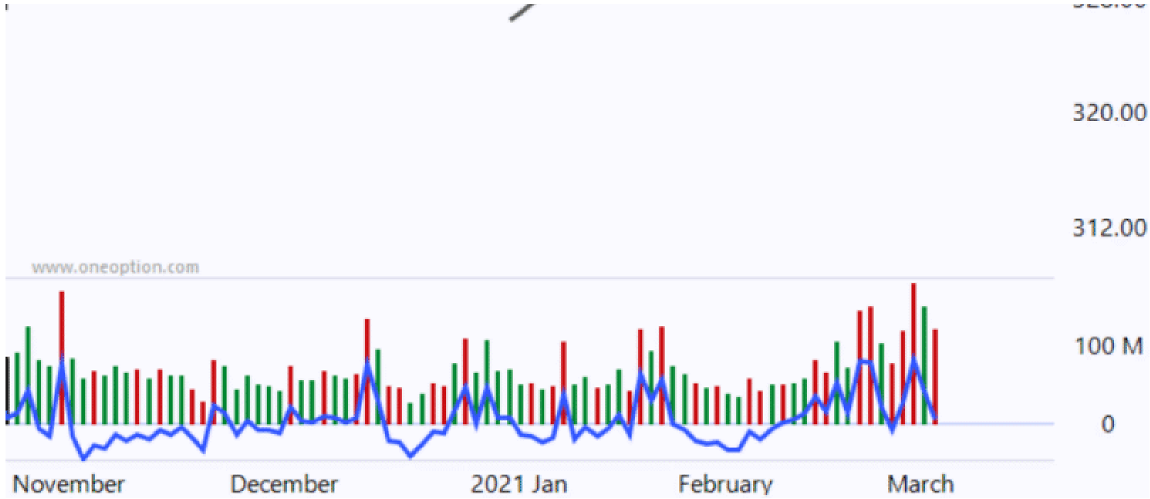
Chapter 2: Swing and Day Trading Are A Must

Novice traders get locked into one duration and you need both. Market conditions will determine which one to use and what the proper mix should be

There's a reason why everything I teach starts with – MARKET FIRST. It is the single most important influence on your success and I believe it is 65% of the puzzle. Yes, getting market direction is critically important, but sometimes there is no market direction and that is equally important to recognize. Let me provide you with some examples.

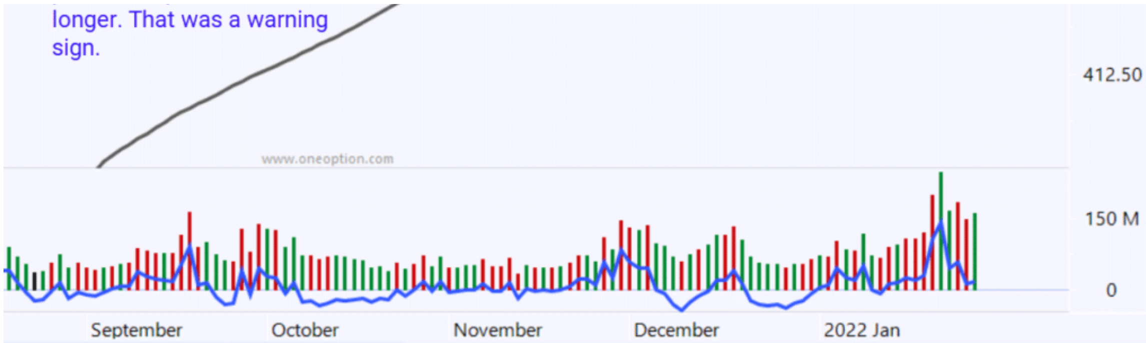
Pre Covid-19

Before Covid-19, the Fed was in money printing mode and they were supporting a 0% interest rate policy (ZIRP). Bonds were not yielding any return so you had to own stocks. That provided a safety net and the market was in a steady float higher. The intraday ranges were minuscule and it was almost impossible to make money day trading. Sure, there were strong stocks that we could trade, but you had to have longer term swing exposure. The majority of the moves came overnight and swing trades were the money makers. If you only day traded, you went hungry and you forced trades. Your focus had to be on swing trades.



2021

At the end of 2021, we recognized that the rally was running out of steam. The typical year-end rally did not materialize. During a time when we don't normally see dips, we were seeing many. In fact, dips in the prior year had been very minor and we would rarely visit the 50-day MA. That year-end price action was a clear sign that conditions were changing. The first step was to trim long swing exposure and to go to cash. In January and February of 2022, we started to see technical confirmation that we were headed into a bear market. The intraday ranges were gigantic. In the early stages of a bear market, the bid will remain stubborn. Sellers will be aggressive and buyers who were trained to buy dips the last decade are still engaged. We had massive reversals from one day to the next. This was a day trader's dream. The moves were so big that I could not justify taking overnight risk, I didn't need to. Swing trading was almost impossible. What looked good one day (or one week) looked horrible the next.



2022

In 2022, if you strip out the high from August and the low from October, the market is in a fairly wide range from $375 to $415. We are not seeing those giant drops and rebounds. From it's peak a year earlier, the 20-day ATR has fallen from $11 to $6 on the SPY. This is a sign that the ranges are collapsing and we are not seeing the type of volatility we had 8 months ago. The SPY also has a higher low double bottom, it has broken the down trend that started in January 2022, it is above all of the major MAs and we have a "Golden Cross."

"Does this mean we are off to the races?" No! There are still plenty of dark clouds on the horizon. The Fed will continue to hike, inflation is still "hot," valuations are still rich, the yield curve is inverted and the economy is likely to contract. Cool. "Does that mean the market is going to hell in a handbasket?" No. Trillions of dollars (record levels) of cash are sitting on the sidelines and I believe some of that is being put to work right now. That explains why the market has been able to shoulder all of the bad headlines. Asset Managers only care if the market is higher than this level a year from now. If they feel that is likely, they will buy dips.

Ignore The Headlines

I mention the fundamental backdrop, but I did not start making serious money trading until I erased all of that MBA crap from my brain. If you think you are smart, do yourself a favor and ignore the headlines. Don't try to rationalize "good news is bad news" and do not try to explain every wiggle and jiggle with some headline. Let the talking heads on CNBC do that. Instead, realize that you do not know shit about fundamental analysis and that price is all you need. Price is truth.

Two weeks ago, the market was in a D1 wedge formation. We had the FOMC, earnings from AAPL, GOOG and AMZN and the jobs report all in a 3 day span. Surely, this was going to spark a breakout in one direction or the other. Since those releases, the market has not done "Jack." Where have we gone? Nowhere! This price action is sending us a clear message. We are in a stalemate. Buyers and sellers are paired off. These are the signs you need to be picking up on.

Bear markets do not always have a "V" bottom. During the financial crisis, there was the threat of a financial collapse. Stocks retreated farther than anyone expected and the threat was real. When that threat passed, we had a huge rebound. In 2019, we had never seen anything like Covid-19. It was a global pandemic. People were dying and the whole world shut down. That drop was severe (some of that drop was caused by over-exposure to the long side because of ZIRP, no hedges and a crowded short volatility trade) and the low came quickly after a couple of months of selling. Those are the most recent bear markets, so those are the ones we remember. Many bear markets transition from a down trend to a horizontal trading range. Yes we will move within that range and we should expect that. In time, the Fed will stop hiking, inflation will subside and companies will grow into their valuations. I believe we are transitioning right now, and we can see that in the wide range from 2022 and the wedge in the chart above.

If you are a day trader, you have the screen time to do swing trading research. I believe that day trading is much harder than swing trading because it requires precision. The same skills you have developed as a day trader (the same patterns, risk management and concepts) can be transferred over to swing trading. The only difference is that you have to get used to taking overnight risk. Like everything, start small and get used to it. For some of you, this will come as a relief because you will not be forced to day trade. You won’t be handcuffed by PDT and you won’t have to worry about monster overnight reversals.

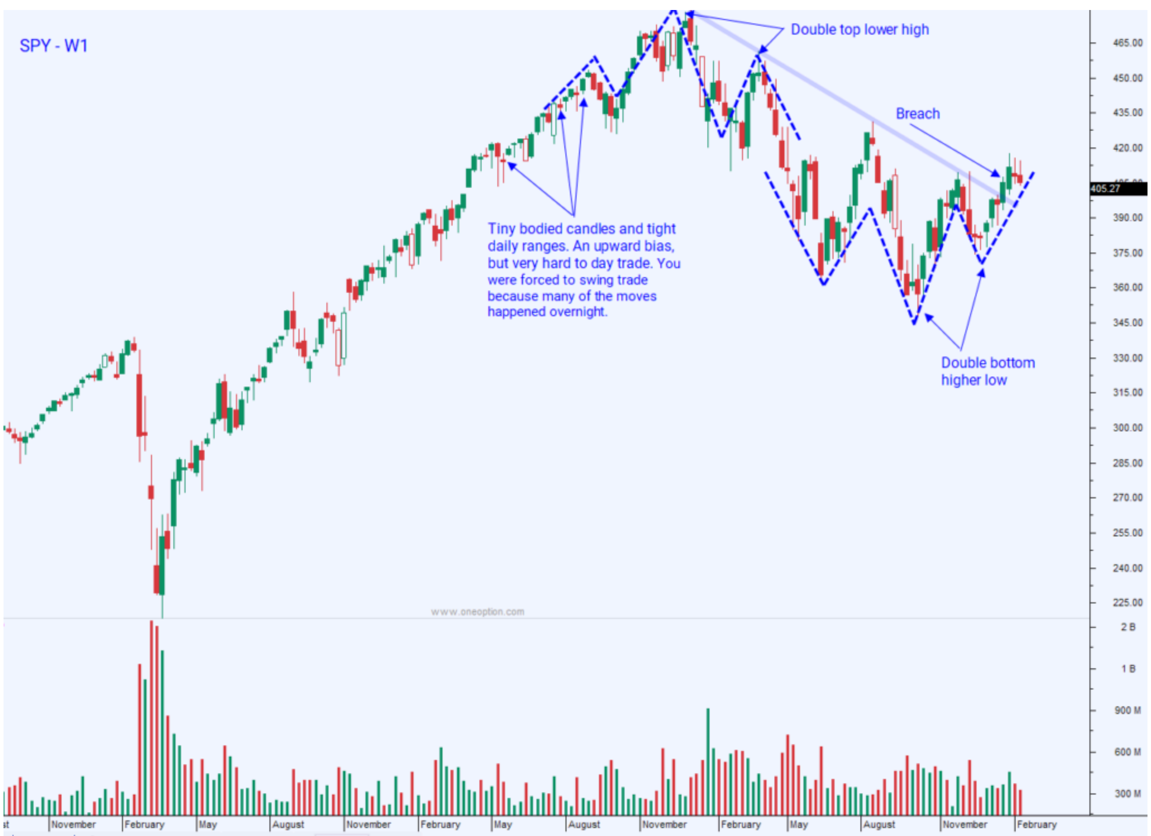
If you are going to be a successful trader, you have to be able to adapt to changing market conditions. If you are only day trading, you are going to find that the things that worked a few months ago are not working. When we string a number of tight “Inside Days” together, you are going to force bad trades. Having some swing trades will take some of the pressure off and they will generate nice income for

Having some swing trades will take some of the pressure off and they will generate free income for you.

Basic Options Strategies

I am going to suggest two very basic swing trading options strategies that you can use. One is selling naked puts on stocks that you want to own and I provided an example in a [video I recorded today](). The other is selling OTM vertical credit spreads. These are generally neutral, but you can add a bullish bias (bullish put spread) or a bearish bias (bearish call spread) to reflect your market opinion. If you are unfamiliar with these strategies, you can learn more about them on my channel or through the [Options Industry Council's]() website. This is a great free resource.

I hope my article encourages you to start adding some swing trades to your game plan. Conditions are changing – MARKET FIRST! Trade well.



Market conditions change and we need to be aware of that.

Our trade duration is a function of market conditions.

Chapter 3: The Danger of Over-Leveraging

There a variety of situations that lead a trader to take a large position. In this article, I will cover the most common reasons and how to identify if your position is too large.

When you allocate a large portion of your portfolio to a single position, you are overleveraged or over-exposed. In general, if more than 5% of your account is allocated to one trade, it is too large. An easier way to determine if your position is too large is to check your emotions. Are you worried about the position? Are you constantly thinking about the position? Do you watch every tick? If the answer to these questions is yes, it is too large.

The problem with over-leveraging is that you can't objectively think about the market or the stock. You are so consumed with the trade that all of the technical reasons for taking the trade become irrelevant. You are emotionally attached to it and you start to see things that aren't there and you find reasons to exit the position at the first sign of trouble. When you entered the trade, you were focused on the upside gains you could make if it works out and now you are worried about how much money you could lose. The bottom line is that "scared money never wins" and you have no staying power. This is why I urge new traders to use 1 share of stock and to work on their win rate. You will not have any emotional attachment to it with 1 share and you can focus on the trade and the surrounding conditions. So why do traders paint themselves into a corner like this?

Greed

The most common reason is that they want to make a lot of money. Why buy 1 share of stock when I can trade 5 call options? I can't pay my bills when I only make a few cents per trade, I need to make a few hundred dollars per trade. Learning how to trade takes years and it is not something you can just jump into and master. In the section titled Unrealistic Expectations, I get into greater detail about becoming a professional trader.

After Big Winners

Personally, my biggest losers would always follow my biggest winners. Your P&L is jumping and you trade as if that streak is going to continue. Recent profits cloud your objectivity and you lose your focus. Conditions change constantly and big runs often come to a screeching halt. When I reviewed my trade logs, I could see this tendency. If you have a "let it ride mentality," I suggest taking a nice chunk of money out of your account when you have a big run. You have to pay yourself anyway so pay yourself well. Then act as if you had a big loss and that is why your account is down. This might not work for everyone, but it worked for me. This grounds me and I quickly regain my focus.

“Can’t Miss” Opportunities

There will be times when a “can’t miss” opportunity presents itself. Every checkbox is marked and this is your time to “swing for the fence.” Your confidence is sky high and you start thinking about all of the money you can make. You enter the trade and you keep adding to it. Once you have the trade on, you start thinking about how devastating it would be if the trade did not work out. You just felt like this was a can’t miss opportunity and now you don’t feel as confident. Out of nowhere, a piece of unexpected news hits and the bottom of your gut drops out. You don’t wait to see if the news was material and you don’t care. All you know is that you have a big loser on your hands so you close the position for a big loss. Not all over-leveraged positions lose money, some will be extremely profitable and that can be even worse. You start thinking about how smart you were and how you “knew” this was going to be a great trade and how you are going to spend all of that money. The big hurt is coming and eventually you will blow up your account. Know that the market has a way of destroying the best laid plans. Keep your balance and your perspective. No one trade should make you or break you.

Revenge Trading

Some traders leverage up because they just took a big loss. They have to make that money back and they think, “This trade really sets up nicely.” I have been wrong recently, but this time I am going to be right. The problem is that you couldn’t shoulder the previous loss and now you are setting yourself up for a knockout punch that could leave you on the mat. When you have a big loss, your first thought should be to figure out what went wrong and to never repeat that mistake again. This is why it is critically important to trade 1 share when you start your trading journey. There will be many lessons along the way and they will be very expensive if you are trading more than 1 share. If you keep getting knocked out, you will run out of money. Yes, even seasoned traders can take a hit, but most of them know that the way to recover is not to ramp up. This is a time to reflect. Pare your size back and gradually work your way back. Be ultra disciplined and only take the best trades where all of the checkboxes are marked. I mentioned earlier that some of my biggest losses would come after my biggest gains. The opposite is also true. Some of my biggest gains came after a draw down. Early in my trading career, my P&L was volatile, but over time the lessons you learn will will help you to avoid pitfalls and your performance will become more consistent.

Final Tips

So here are some tips that might help you. If you are emotionally attached to the position, it’s too big. If you think this is a “sure bet,” the market is likely to throw you a curveball. If you have had a big run, take some “chips” off of the table. If you’ve had recent losses, don’t ramp up, hanker down. The key to successful trading is to always stay in control and no one trade should make or break you. Trading should not be nerve wracking or exciting, it should be stable, calculated and controlled.

Chapter 4: Small Accounts Can Be A Problem

Novice traders are often excited to start. They've heard about the fortunes that can be made trading and they are determined to try with what little money they have.

"You have to start somewhere" is the attitude most novice traders have. They have cut expenses and they have scraped together all they have to fund an account. This money is their "ticket" to fame and fortune. They've watched a few videos and read a couple of books and they feel they have the "basics" down pat. The few thousand dollars in the account is very meaningful to them and in some cases, that money might have "temporarily" been borrowed from funds that are going to be used to pay bills. Right out of the gate, the novice trader is going to be faced with the issues of being under-capitalized/overleveraged. They have no staying power because they can't shoulder a loss, they have little to no experience so they are going to be in bad trades, they have no track record and hence very little confidence when a trade goes sour. This is a train wreck in the making.

Unrealistic Expectations

One of the reasons novices think that a small account might be viable is that they have unrealistic expectations. I will cover this in great detail in the next article. Perhaps a friend of theirs made money on a trade and that gets them excited. If you search long and hard enough, you will find a "guru" who tells you that it only takes a few thousand dollars to get started. Avoid these scam artists at all costs. They are the only ones who will make money selling you their "secrets." This profession is very hard and it takes years to develop the skills you will need.

Exhaust Your Resources

So what's the solution? This is a journey and reading books is an inexpensive way to get started. If you plan on becoming a short-term trader, books on technical analysis will teach you the basics. Focus on free sources of information. The WIKI is an incredible resource and you have access to The System. That's what you are reading right now during the free trial. I don't charge anything for this, but I could. Watch YouTube videos. You will have to try many different channels until you find someone who actually teaches you how to trade, but once you find that source, exhaust it. Avoid any site or channel that promotes big profits. All of this information is going to teach you about trading, but it won't teach you how to trade. That is something that is learned through experience.

When you find an approach, it has to have a decision making process. 1. Start here. 2. Check this. 3. Check this. 4. Check this. The structure is clear and you know the exact steps to follow. The next step is to actually try some trades. You can start with paper trading, but I prefer trading 1 share of stock because you actually have some "flesh in the game." You will be able to track your success and learn from your mistakes with little to no emotional distress. Until you have a win rate that is greater than 75% for a few consecutive months, you do not increase your size. Reaching that level will take years and you will start to appreciate how difficult this is.

Be Patient

Most novice traders will not follow this advice. In the age of instant gratification, that process will take too long. They learn what they think they need and they start trading. The account blows up in short order and they are added to the long list of failed traders. Don't be like them.

"So Pete, how much money do I need once I reach that 75% win rate level?" By the time you get there, you will know the answer. Hopefully, during your journey you have had time to add more money to your trading capital. Given how hard it was to reach that point, you will know to gradually increase your size and you will keep learning.

Chapter 5: Unrealistic Expectations

Novices believe that trading is an easy way to make money. If this was true, most of the people you meet would be professional traders. How many pros do you know that have been doing it for more than 5 years?

Anyone with a wallet can open up a brokerage account. The barriers to entry are very low and if you have an good internet connection, you can start with a few hundred dollars and trade with zero commissions. The market always goes up so how hard could it be? This is the prevailing mentality for new traders and there are many reasons why it exists.

This perception is fostered by brokerage ads like the baby who is trading (Etrade). "It's so easy, even a toddler can do it." There are countless advertisers on social media promising riches if you just sign up for their "5 start alerts" or their indicator (you don't have to look farther than the ads on my YouTube videos). Your friend/neighbor/relative boasts about their big options win and you think, "hey if they can do it so can I." Most people are trying to get ahead in life and they are looking for the path of least resistance. This seems like an effortless way to make money.

like an effortless way to make money.

"Pete you're a hypocrite. I see you promoting the 1OP indicator and the Option Stalker Pro searches in your videos." Let's address that. These tools will help you to find great trades, but they won't make you a great trader and I never promise riches. The System provides a structured decision making process and there's an edge to it, but I don't guarantee success. In fact, I go out of my way to tell people how hard this is going to be with videos like What Is Day Trading? & OneOption Is Not Right For Everyone.

I don't advertise because I'm not going to lie. Who's going to click on an ad that tells you this is going to take years to learn, it is an incredible amount of effort, and there is a chance you will be humiliated? No one, that's why we don't have thousands of members. I am trying to be as honest as I can when it comes to trading and I want to be a beacon of light in a sea of shit.

So let's take a look at some of the things you should expect during your journey to become a professional trader. If you are not passionate about this, you will not put the required time in and you will fail. This has to be something that you must truly enjoy doing. Then the 60+ hours a week you put in will go by quickly.

Education

Before you start trading, you have to understand technical patterns and indicators. That means you have to spend countless hours reading books and learning how to find the set-ups that present the greatest opportunities. You have to read through user manuals to find out how to utilize the tools you have (software). You have to understand the rules and regulations imposed by the industry (PDT, taxation) and you have to understand your brokerage agreement (assignment/exercise). Learning how to trade options requires another level of studying.

Preparation

I start my trading day 3 hours before the open. I am scouring the headlines, gauging the reaction to economic releases, looking at stocks that have moved overnight and devising a game plan for the day. You can see the end result in my pre-open market comments.

Research

I spend 3 hours after the close looking at post earnings reactions, running searches for new trade prospects, setting alerts and reviewing trade logs to see what went "right" or "wrong" with the trades

Expenses

There are software expenses (scanners and trade logs), data expenses and news feeds. You also have all of your monthly personal expenses that you have to cover with your profits.

Time

You have to put in years of effort before you make a dime. Most people are not willing to put in the work and they are not willing to wait that long. They want and expect instant success.

Emotions

This journey will teach you more about yourself than you can imagine. How willing are you to admit that you are wrong? Without any measurable progress, how willing are you to keep putting in the effort? How will you handle tough trading conditions when its hard to make money? Do you have the mental fortitude to push forward when everyone else is doubting your career path? How will you handle drawdowns?

Losses

When you have a “bad day at work” in other professions, you still get paid. When you have a bad day of trading, money is taken from you. The next day, you have to make that money back, you have to make what you should have made the day before and you have to hit your daily profit target. This is a very slippery slope and that is why consistency is critically important.

Conclusion

If you are a professional, by definition, you have mastered a trade/skill and that is what you do full-time to make money. If you wanted to be a doctor, a lawyer or a professional golfer, everyone would appreciate the time and effort required to make that a reality. The same effort is true for trading, but unfortunately, that is not the perception. Are you passionate about trading? Do you have what it takes?

Chapter 6: No Game Plan!

You need to have a weekly and a daily game plan. Without one, you are just “flying by the seat of your pants.”

Many traders don't have a game plan. They turn on their monitors and they log into their brokerage accounts when the opening bell rings. They have no clue of what the market has been doing in recent days because they didn't do any technical analysis. Consequently, they don't have any clue of what the market might do or why. They don't know the most likely scenarios or the ones that would present the best trading opportunities. They haven't read the overnight news, they haven't looked at the pre-open movers and they don't know what happened overseas. If there was an economic release, they don't know how the market reacted to the news. They don't know how they've traded recently or what they should focus on. As far as a market opinion, they might have one, but it is not supported by any analysis. They are just going to take the day "as it comes." They will be reactive instead of proactive.

Market Analysis

Market analysis is critically important. That contexts provides the framework for all of our trades. We know where we stand technically on a long-term basis. Our market opinion and our confidence in that forecast determines our trade duration, trade size and options strategies. The overnight news and the overnight movement in the S&P 500 sets the tone and we see how today's puzzle piece might fit into the overall picture. The price action from the last two days will also provide us with valuable clues on how the day might play out. Is the market in a longer-term trend? Have the recent intraday ranges been compressing? Is the current day likely to be a "Gap and Go" or a "Gap Reversal?" Is it likely to be a "inside day" or could it evolve into a trend day? Are there any major economic releases that are scheduled today or tomorrow? Have they recently had a big market impact? Is this a day where I should reduce risk? Could the trading today be dull ahead of this major news event? What has the market volume been like? Are there any major technical support or resistance levels that are in play today? Have any been breached recently? A trader has to know the answer to all of these questions ahead of time and he has to devise a game plan.

Stock Watchlist

Which stocks am I focused on? Which ones are moving overnight? Do I own any of them? Do stocks that are moving overnight belong to a group I have exposure to? Might that have an impact on my stock? What is the news that is driving that stock? Is it material? Which groups are strong/weak? Are there any stocks from the prior day that looked attractive? Did I set alerts so that I am notified when a trade sets up? Have I set alerts on the stocks I have a position in to alert me if they are going higher or lower? Were there any earnings releases after the close the prior day or before the open that might be of interest?

Recent Performance

How have I been trading recently? Am I over-extended or under-allocated? Should I be looking to reduce risk? Should I be adding to positions? Has my forecasting been accurate? Is there anything from my trade logs that I should be working on? Is there anything I should avoid? What are the most likely scenarios that will play out today? Which scenarios present the best opportunities? How will I know when these scenarios set-up?

Write It Down

I've found it very helpful to conduct all of this analysis and then to write down my game plan. You can create a table with checkboxes, but writing things out is better. If you write in great detail, you can comment on how you did after hours in your trade log. I still write out the game plan for members in the chat room and they come in the form of my pre-open market comments. In the early stages of your trading journey, I highly suggest that you do this. Start your day early and prepare. When the opening bell rings, you need to be alert and ready.

NFL quarterback Tom Brady is the first one to show up each day and he is the last one to leave. He is rested, mentally alert and well-prepared. He studies before, during and after the game. He knows which match-ups favor success and which ones to avoid. When opportunity arises, he executes. You need to do the same.

Chapter 7: The New Shiny Object

Novice traders are constantly searching for the "Holy Grail" or the "Black Box." It doesn't exist and this quest is going to make your journey much longer than it has to be.

Everyone wants to make as much money as they can and they want to expend as little effort as possible. This is particularly true of people who want to get rich quick or who have tried the "hard way" and their trading is not progressing. "If only the alerts did this. If only the indicator did that. I watched a video of a guy who uses a variation of XYZ indicator and it nails the moves. There's this programmer who designed this automated AI trading algorithm and he is only offering it to 100 traders. Has anyone followed Trader Joe? He has a lot of followers and he is selling his system." Does any of this sound familiar?

Now that I've written the paragraph, it does sound similar to The System (except that I don't charge for that education), Option Stalker Pro and the 1OP indicator. The difference is that I'm not promising you riches or even success. The System provides us with the decision making framework and I explain why the edge exists, the Option Stalker Pro searches help us identify the best stocks, 1OP helps us to gauge market direction/strength and the chat room brings all of the puzzle pieces together in real-time. You still have to do the heavy lifting and I hope that none of my members feel that I am promoting a fast or easy way to make money trading.

The Truth About Trading Systems

The industry is filled with liars who prey on the greedy and the lazy. If these “gurus” had an easy way to make money, they would beg, borrow, and steal to fund their own personal trading account and they would work the “special indicator” or the “Black Box” system until the cows come home. If it is truly special, they would eventually make so much money trading it that they would run into liquidity issues because they can’t get enough size off. Why would they want to share this with anyone?

To be brutally honest, if I could find a way to automate a 1OP trading system for /ES, I wouldn’t share it with anyone. Trust me, I’ve tried for years and I have spent a fortune on this quest. My reality was that the indicator while useful, still required interpretation. The same is true of all of the trading I’ve done. The human brain can process so many variables and it can adapt to changing conditions. My conclusion years ago was that the only way to trade is to do it manually.

Ditch “Get Rich Quick” Schemes

Here’s the key to this article. Don’t focus on get rich quick schemes. If the “Black Box” was good, they would not sell it to you. If there is a track record, was the P&L verified? Over what period of time? Certain systems work well in certain markets, but they fail miserably in other markets. Why are they selling it, why don’t they just trade it?

The System I teach and that we trade has been time tested and we are all living proof that it works. You can see it in the trades that are posted each day in the chat room. I’ve spent years testing the indicators that I suggest using. Every indicator measures price movement, volume and time. They are all variations of each other. Get proficient with your trading and focus on your win rate. Don’t let yourself be distracted by some new indicator. Once you’ve mastered this and you are successfully trading, then you will have time to experiment with other concepts and strategies. This curiosity is healthy and I encourage it. The point is to master one method that consistently produces results before you move on to something else. When you do move on, experiment with your own concepts and not something that an unknown “guru” is trying to sell you.

Chapter 8: How To Avoid Tunnel Vision

Many novice traders fall in love with a stock or a strategy and they are oblivious to everything else that is happening around them.

I wish I had a nickel for every time that I’ve seen this. A trader will comment on one of my Reddit posts or ask for my opinion on a stock on my YouTube channel. When I bring up the chart, the stock is choppy with no for my opinion on a stock on my YouTube channel. When I bring up the chart, the stock is choppy with no direction. It is trapped in a tight trading range and it has light volume. With thousands of stocks to choose from I wonder, “What they could possibly see in this stock?”

The answer is… they have fallen in love with it. Perhaps they’ve made money on it before or they read a news story that really has them excited about the company. As short-term technical traders, we don’t conduct fundamental analysis. We are aware of scheduled events that might impact it (i.e. earnings), but we do not try to predict the outcome. If the stock is “stuck in the mud” we set alerts at critical price points and we wait for a heavy volume breakout. When the alert is triggered, the stock might be worthy of our attention. Until large institutional traders are interested in the stock, we let it sit and we look elsewhere for opportunity.

Tunnel Vision Examples

These next four scenarios are fictitious, but typical.

“Pete, what do you think about Apple?” It is chopping around on light volume and it is wedged between the 100-day and 200-day SMA. It is still trapped inside of the prior day’s range and it is in a longer term compression with light volume. “I think you have a position in Apple. That is the only reason you would ask me about this stock.”

“Pete, what do you think about Tesla? It’s bouncing off of the 100-day SMA and this could be a good long.” Tesla has found temporary support at a major moving average, but the stock has been weak relative to the market with a heavy volume drop down to that support level. We need more proof that support is going to hold and we need to see the stock rally through technical resistance for confirmation. We also want to see it regain its relative strength. Until then, we understand that the stock could just as easily reverse this bounce and plunge below the 100-day MA. “I think you are itching to buy Tesla and you might have a little bottom picking tendency that is obscuring your vision.”

“Pete, what do you think about selling an OTM bullish put spread on Microsoft? It has relative strength and it has been able to hold this horizontal support level.” The S&P 500 has just broken through the 100-day and the 200-day SMA on long red candles with heavy volume. I think you are in love with selling bullish put spreads. This is a great options trading strategy when the market is neutral to bullish and you are oblivious to the market conditions around you.

“Look at Nvidia scream higher!” This is one of my favorite “tells” that a trader has a position on. I look at the $500 stock and it just moved $.50 higher. This trader has his pom-poms out and he is playing cheerleader. He is camped out on this stock. He’s watching every tick and he is seeing what he wants to see. Chances are, this is his only position because there would be many others he could have highlighted instead. Nvidia could be trapped inside of the prior day’s range and the S&P 500 could be up 50 points, but he still sees this $.50 pop as a victory even though there are hundreds of better opportunities. Without question, he has tunnel vision.

Market First, Stock Second

The System starts with long term market analysis. It is critically important to know which way the wind is blowing and how hard it is blowing. The goal is to have it at our back. Then we get the shorter-term market context and we see how the current move fits into the larger picture. Next we find stocks that are moving in the direction of that wind with ease (long candles of a single color through key technical price points on heavy volume). This is a sign that institutions are supporting that move. If you use this decision making process, you will avoid the tunnel vision trap. Instead of starting with “interesting” stocks with a headline that have good option liquidity, but no movement, you will start with the macro backdrop and drill down to the best stocks that institutions have a strong opinion about right now. That is accomplished through stock searches. The goal is to join that move.

Traders have awareness and they know that many checkboxes have to be marked before a trade is taken.

Chapter 9: Market First! Don’t Take Your Eye Off of the Ball

In almost every instance, I can trace a bad trade back to what was happening in the overall market.

If you only learn one thing from me about trading, learn the concept of Market First. The market drives all of our decision making and 75% of all stocks follow the market. To illustrate this another way, we are trading the market, but we are riding the fastest horse to increase our odds. Is picking the right stock important? Yes, but not as important as getting the market right. This same principle applies to swing trading and day trading.

Traders often ask me to review a trade that went “sour.” They explain all of the checkboxes that were marked and how the “short” looked ideal. They can’t understand what went wrong and they ask me when they should have stopped this loser out. My answer is often a question, “Why did you short a stock when the market was going up?” The very first and most important checkbox was not marked and it was the D1 chart of SPY. All ships rise with the tide and no matter how great the short looked, you needed to wait for the market to align with the short. Furthermore, any stop would have produced a loser. The key was not to take the trade in the first place.

I’ve had plenty of instances where a trader is frustrated. They had excellent performance during a recent stretch and they thought they had "figured everything out." Then all of a sudden, their winning percentage drops and they are right back at square one. When I point out that the market was in a nice move higher during their winning streak and that it has recently compressed/stalled, it is almost as if they are hearing the concept of market first for the first time. When you get a nice market run and you are killing it, look for signs that the momentum is starting to wane (bearish hammer, bearish engulfing candles, compressed intraday ranges, mixed candles, wicks…). Start taking gains and reduce your risk exposure. In time, that move will be exhausted, but many traders act like it is going to last forever. There is nothing on the D1 chart to suggest that, but they keep on buying.

Swing Trading

There will be times when we don't have a great read on the market for swing trading. That could be the case if it is compressing in a tight range. There will be a breakout one way or the other, but we don't know which way. While we wait, there are bullish put spreads that we can sell on strong stocks and bearish call spreads that we can sell on weak stocks. These are fairly market neutral strategies that will benefit from time decay while the market is trapped in a range. There could be times when the market has huge overnight swings without any real trend (2022). Again, we can't get a good read on direction. The volatility tells us that buyers and sellers are engaged and that we could get a big move one way or the other. In these instances, we should focus more on finding day trading opportunities. The moves intraday are good, but we want to limit our overnight risk exposure so try to be "flat" by the end of the day.

Traders will often get locked into a particular strategy. Selling out of the money bullish put spreads is a bread and butter strategy for swing traders, but you need a neutral to slightly bullish market. Traders who have successfully traded this strategy for years (2010-2019) will fail miserably in a bear market (2022).

The D1 market context is also important. Are we seeing mixed candles with lots of overlap on light volume? This is a sign of a weak trend. Are we seeing tiny bodied compressed candles with marginal new highs after a nice rally? This is a sign that the market is likely hitting resistance and that we can expect a dip or a drop. If the market is compressing on a D1 basis and the intraday ranges are small, we will see that on the chart. In this instance when the market opens inside of the prior day's range and the volume is light, it tells us to keep our day trades to a minimum. The day trader who keeps adding new positions is going to take a beating in this environment. Every M5 breakout that looks great is going to reverse.

Is the market breaking through multiple resistance levels with stacked "greens" and good volume D1? That is a sign that the trend is strong. From all of our earlier lessons, we know that an overnight market gap down in a strong up trend is our best case scenario for bullish day trades. That drop will allow us to enter longs at a good price and as the gap reversal takes hold, there is plenty of upside as the market recovers. That opening gap down also gives us a chance to evaluate/find stocks with relative strength. The strongest stocks will still be near the prior day's close and they will be ticking higher even before the market finds support. As the gap fills, this could turn into a bullish trend day and that would mean that we should ride the move higher as long as possible. The day trader who is oblivious to the market will take early gains like they always do and miss incredible profits. If the market is trending D1, we can use that tailwind and enter trades with a directional bias. If our confidence is high and the trend is strong, we can get aggressive with our trades. We can add to our long positions and we can use more aggressive trading strategies like buying ATM call debit spreads. With a strong market trend it also means that we can take larger positions and that we should be inclined to let winning trades run.

Day Trading

Traders will often enter day trades poorly. They have zeroed in on the stock and after making a series of new highs for the day, they can't resist temptation any longer and they buy. At that time, 1OP for SPY has a bearish cross M5. That is a sign that the market is ready to roll over. At very least, see what that bearish cycle produces in the next 15-20 minutes. There is no harm in waiting. If the market rolls over, the stock is likely to do so as well. If the selling accelerates, you will be glad you did not buy the stock. If the market rolls over and the stock hugs the high of the day, you know you have a strong stock. As soon as the market finds its footing, you can buy with confidence. If the bearish cycle on SPY is benign, you can take comfort knowing that you are not trading against a weak market and you can take a long starter position.

Our D1 confidence in our market forecast sets the tone for everything we do. It determines our trade duration, our position sizes, and the number of trades we do. Market conditions impact our stops and our targets. There will be times when our confidence is high, but the trend strength is weak. We are sure that the market will be trapped in a range. This is when we reduce our size and when we favor neutral strategies. There will be other times when the trend is strong and our confidence is high. This is when we can get aggressive with our trades. We can also extend the duration of our trades. Instead of focusing on short term moves, we can take longer term swing trades. We should also set higher targets on the notion that the move will have follow through. What ever is happening on a D1 basis is likely to transfer over to an M5 basis as well.

Regardless Of Time Frame – Market First!

Don't take your eye off of the ball. We are trading the market so always have a D1 and an M5 chart of the SPY up. When you are reviewing your trade logs, I highly suggest that you start with the market backdrop D1 for swing trades and M5 for day trades. Here is a video I did on trade log analysis.

Chapter 10: Don't Be A Copycat

Many novice traders follow others who "know more" and they lose money.

People trade because they want to make money. Novices know that some skill is required so they lean on sources of information that they believe are reliable. Most of them don't appreciate how hard it is to make money trading and only a handful of them are willing to put forth the effort to learn how to do it. Their initial game plan is to follow the advice of others and to add some of their own "insights" along the way. As they get better at trading, they will rely less on other sources and they view this as a temporary "crutch." Let's start with some of the potential sources of information they might use and then let's look at the danger of following others.

Following OneOption Trades

Since you are reading this article, let's start with OneOption. "Surely Pete and the Featured Traders know more than I do, I'll just follow their trades." The trades might be posted in the chat room, tweets or in recorded videos. You've had some time to observe some their trades and they've performed well. You are getting a good "vibe" and this should be easy. "I'll just get in when they do and I'll get out when they do."

Out of all of the potential sources that you could follow, I would put our chat room at the top. This is a well conceived and well documented systematic trading approach and all of the trades posted conform to this decision making process. That said, how well do you know the other traders in the chat room? Have you seen their P&L? Do you share their risk tolerance? The entries and exits are posted on a timely basis, but there is a lag from the time the trader gets a fill, to the time they post the trade, to the time you read the post, to the time you place the trade and until you get a fill. You are always one step behind and this is critically important when it is a short-term trade and when the market is moving quickly. Members post trades to share ideas and they serve as a real-time example of The System in action. You should go back and analyze the entry and exit of each trade that is posted. Learn from these trades and look for the common characteristics/patterns so that you can refine your own trades.

If you came to OneOption to get rich copying other people's trades, you came to the wrong place. Every ounce of energy is focused on teaching you a systematic decision making process that will increase your odds of success. There are hundreds of articles and videos to help you through the process and they are free. That is why we suggest starting with 1 share of stock. Until you have a 75% win rate for a few consecutive months, you stay at that level. When you reach that milestone, you will have many of the required skills you need to make sound trading decisions on your own and you can gradually increase your size. There will still be plenty of "bumps in the road" so you increase gradually. You have respect for how hard this is and you've learned how to avoid most of the lethal pitfalls. During the journey, you will also notice that some of the people that you considered following are no longer trading. If you are on the free trial, don't trade the picks in the chat room. The trial will end and you will be no better off. Learn The System, test the tools that will help you find great stocks and analyze the trades you see posted. Let's take a look at some of the other sources of information and then let's discuss the dangers of following other traders.

News Channels

CNBC, Bloomberg and Fox Business News are the TV trading giants. They make their money off of “eyeballs.” The more viewers they have, the more they can charge advertisers. They accomplish this by sensationalizing every headline and they want you to believe that it would be impossible to trade without this valuable information. The anchors are not traders, they are reporters. They are there to explain every market “wiggle and jiggle” and to entertain you. They have no trading track record and they are not accountable for anything they’ve said in the past. Yes, some of them manage long-term investments. Do they post how their track record compares to the S&P 500? No. The same is true for the guests. They are there to promote their funds. If they sound intelligent and they look good, they’ve helped their brand. By the time you’ve reviewed all of the comments made by the anchors and the guests during the course of a trading day you’ve reached the conclusion that the market could go up, stay flat, or go down. I have not watched one minute of these programs in over 20 years. If you want to learn how to trade, turn that noise off and focus on price.

Large Trading Firms

Large trading firms like Goldman Sachs, JP Morgan Chase, Morgan Stanley and others produce “inside research” for their big accounts. The first thing you should know is that the proprietary trading arm of these firms operates behind a “Chinese Wall.” They are trading the firm’s capital and this information is highly guarded. By SEC rule and regulation, it is illegal for these proprietary traders to discuss their activities with anyone outside of that circle. If you think about it, sharing that information would be disastrous for the firm because competitors would know their exposure. It would be like showing your hand in a game of poker. The other analysts for the firm operate outside of the proprietary arm. They conduct research and they publish their analysis for their clients (funds and high net worth customers) along with recommendations. These analysts upgrade and downgrade stocks based on their findings. A few times a week, we will see a stock with incredible relative strength and we will take a long position. The next day, the stock will be upgraded by an analyst. The news was released internally the day before and they were taking positions in advance of making it public. The next day, the stock shoots higher. Our goal is to follow the institutional money and we don’t need their research, we just need to follow their bread crumbs via price action. By the way, many analysts in the firm are often wrong long-term. They are constantly revising estimates and price targets and they are always “one step behind.” When I am in a trade that benefits from an overnight upgrade, I will ride that initial surge as long as I can during the day and then I will take gains. These moves are often temporary.

“Gurus” Outside Of OneOption

We know that following OneOption members is not wise, but at least they are following a systematic decision making process and you have some notion of the basis for the trade. Following traders outside of OneOption is foolish. This includes your brother in-law who has “traded for years,” your neighbor who drives a nice car, your co-worker who just made a killing buying calls or someone you met on Discord who talks a good game. You don’t know these people and you don’t know how successful they’ve been long term. You don’t have proof that they are actually making money. No one is going to share their P&L and it would be insulting for you to ask them for one. You also don’t know how consistent they are or what their drawdowns have been you to ask them for one. You also don't know how consistent they are or what their drawdowns have been like. They will brag about their huge wins and you will never hear about the losers. You will be jealous and you will feel stupid for not putting your money to work like they do. Do not follow these people!!

There is no shortage of “gurus” who are going to share their “secrets” and make you rich. First of all, who are these people? Besides their advertisements, what qualifies them as a good trader? Unless they are sharing all of their trades real-time with entries and exits, I wouldn’t trust them. Brokerage statements can be photoshopped. A common “trick” is to highlight a period where they performed exceptionally or to “cherry pick” the best trades. These “gurus” spend a ton of money on advertising. They prey on greedy, lazy folks who want to make a fortune following someone else. According to the ads, you can make money trading while sipping Pina Coladas poolside. Of course, sharing their their trades will come at a hefty subscription price. If you buy their educational programs, the “secrets” are recycled concepts you could have gotten from a $50 book on technical analysis. This is a business for them and they want to make money selling you their advice. Here are a couple of great questions to ask yourself. Why would a great trader want to share their secrets? They wouldn’t. In fact, they will go out of their way to conceal what they are doing because they want to fly under the radar. Why would a great trader need your money? They wouldn’t. Their best use of time and energy is to trade.

Do Your Own Homework

If you are studying for your law degree, you can cheat and copy someone else’s answers on a test. Hopefully they know the right answer. Even if they do, you have not learned a thing and when it is time to take your boards, you will fail miserably. The same is true for trading.

Two people can take the same trade, but their risk tolerance is not the same. One trader might be willing to let the trade move wildly against them while the other needs to maintain a tight stop. You don’t know the other person’s risk tolerance when you follow their trades. You also do not know their time horizon. Is this a day trade or a swing trade? You also don’t know why the other person took the trade. What was their long-term and short-term market bias? What was their level of confidence? Do you share that opinion? What did they see in the stock on a long-term and short-term basis? What were the technicals they were leaning on? What was their game plan? How will you know when you are wrong and where will you set a target? What is the position size and how will you know if you should add to the trade? Is the other trader aware of scheduled events that might impact the trade? These are all critically important questions that need to be answered.

If you ask the other trader for these answers, they will reply, “Do your own homework.” They don’t have time to answer your questions and they are not interested in spoon feeding you. If you make money on the trades, you will be excited. Now you have a “golden goose” and you will be eagerly waiting for the next “golden egg.” You will become more and more dependent on that trader for new ideas. If the trades start to lose money, you won’t know why. You were not a part of the decision making process so you don’t know what to change or what they might have missed. At anytime, the other trader can decide not to post their trades and you’ve learned nothing from the experience.

Be The Lead Dog

When I write articles like this I am more critical of myself than I am of others. I'm not a hypocrite and I am proud of what I've built and the people I've helped. When I post a pick in a video, I always review it in the next video so that you can gauge the performance. I am not charging you for my picks and I don't want you blindly following them. They are real examples of trades that are setting up based on the system I teach and I explain in great detail why the trade is attractive. The vast majority of the education I provide is free for everyone and the rest is free to OneOption members. I'm not charging you thousands of dollars for this, but I could. Yes, I offer a platform. So do TC2000, Trading View and others. The software is not going to make you rich and you will never hear that claim from me. Yes, I offer a chat room that focuses on the system we trade. Yes, I charge for them. It is expensive to develop/maintain/support them and I would like to do better than cover my costs. I want to teach as many people as I can, but I am not going to do this to my own detriment and expense. You do not need Option Stalker Pro and you do not need the OneOption chat room to learn The System and to implement what I teach.

Don't be a copycat. Either roll up your sleeves and learn how to trade or walk away. You will not get rich following anyone else. The view is always the same if you are not the lead dog. Be the lead dog!

Chapter 11: Know When The Odds Are Low

Often the best trades are the ones you don't take.

Throughout this course, I discuss the importance of context. I am going to reference shorter-time frames on SPY for day traders, but these same principles apply to longer time frames. The market drives our trading and it is critically important to understand how today's puzzle piece fits into the longer-term narrative.

There are about 250 trading days in a year and most of them are dull. The context of the current session is going to set your expectations and you will build your game plan around the most likely scenarios. The mistake traders make is that they treat every market day the same as the previous day. When a novice trader has a very profitable day, they expect to repeat that performance the next day. They extrapolate this out over a month and then a year. With this level of performance, they will solve the national debt in a decade. Unfortunately, all of that money they made under the best of conditions will quickly be given back.

A low probability trading environment (LPTE) needs to be handled with care. This is when we reduce our trade count and our trade size. If you fail to recognize this condition and you fail to adjust your trading, you will squander all of the hard earned money you've made. In this article, I will discuss some of the things you should watch for.

Inside Day

The prior day high/low is the first minor resistance/support respectively. If the market can't move through those levels it is likely to be an "Inside Day." If the market breaks out of that range in the first hour of trading, it has a chance to keep going. If not, the prior high and prior low will be more difficult to breach. This is a sign that you should trim your trade count and trade size. Within the market we will often find a "hot" stock or a "hot" group. The good news is that you will not have to worry about the market rug getting pulled out from under you. The bad news is that you will not have a market tailwind and the stock will have to do all of the "heavy lifting."

Big Prior Day Move

It is rare to see back-to-back big moves. If the market moved more than 1.5 times its 20-day average true range the prior day, there is a good chance the current session is going to be an "Inside Day" and the market is going to take a rest. If you look at a daily chart of SPY, you will notice that there are not many long candles stacked consecutively. Before the open you understand this and you build this into your game plan.

Major Pending News

The market will often pause before a big event. It could be an FOMC statement, a big economic release, a major round of earnings releases, an election result or a debt ceiling agreement. This is a binary event and often the market will swing one way or the other after the news. If the expected impact is huge, traders will wait for the reaction. This means you keep your trading to a minimum the day before. The worst thing you can do is to force trades. You enter poorly and the stock moves against you. Now you are stuck in the trade. You want to keep your overnight exposure to a minimum so you exit the trade for a loss. Recognizing that the day was likely to be dull might have kept you out of the trap.

Summer Doldrums

August is typically a very slow month. The Fed is in recess and politicians are on holiday. The action dies down and traders take vacations before the kids head back to school. Earnings season winds down and we enter a "news vacuum." This is a time to tread very cautiously. Here is an exercise you can conduct. How many trades did you do in August? Did you make money? How does that month compare to other months? Chances are it was subpar, so this year plan to take some time off in August. Eliminate the temptation to trade, recharge your battery and prepare for a busy fall.

Holidays

Holidays

As you look ahead, be aware of exchange holidays. The action will die down the day before and the day after the holiday. Build this likely scenario into your game plan. Instead of looking for reasons to trade, you are focused on reasons not to trade.

Longer-Term Compression

If the market is trapped in a longer-term range, the price action will compress. You will see mixed overlapping candles and in general, the volume will decline. Buyers and sellers are in agreement and that means that the intraday price action is also likely to be dull. After a big market move that has lasted for weeks, the market will often compress and digest gains. This condition might have lasted months and the 60-day high and low have been the same for a long time. You could also see price compression after a big move. Tiny bodied candles with wicks and tails form on the D1 chart. This tells you that the market is digesting the recent move. It tests both sides during the day, but it closes near the opening price. Once the market is in a pattern, it tends to continue that pattern. Build this into your trading plan.

Long Mixed Overlapping M5 Candles

This is a sign of indecision. If the volume is low, the action will be very choppy and you will not have a clear sense of direction. Buy and sell programs are driving the action. If the volume is heavy, there is a good chance that one side or the other will prevail during the day. Set alerts at the high of the day and the low of the day and don't try to guess the direction. A breakout early in the day needs to have immediate "escape velocity" or the risk of getting sucked back into the range increases. Keep your trading to a minimum until you have technical confirmation and immediate follow through on a breakout.

Low Volume

A low volume "Inside Day" is a low probability trading environment. Error on the side of not trading. However, a low volume "Outside Day" can often turn into a trend day. If the price action is orderly and steady in one direction, it can be traded. If it is contra to the longer term D1 trend, you have to be careful. Don't get trapped in a bad day trade. You don't want to hold that position overnight since you are on the wrong side of the longer-term market trend. If the light volume breakout favors the longer-term trend, you could have a nice trading opportunity. Often, the momentum during the day builds and the volume starts to increase. If a nice trend is established, you might even consider holding a few "overnights."

Every market day is different so you need to trade it differently. The longer-term context will help you to frame the current day. How does today's puzzle piece fit into the longer-term picture? Look ahead for these patterns and events and incorporate these potential dead spots into your trading game plan.

Your goal is not to trade, your goal is to make money. You are the professional Black Jack player counting cards and you need to vary your bet. When the odds favor you, increase your bet. When the odds are against you, bet small.

Chapter 12: Trade What You See And Not What You "Think

This just in… you're not that smart.

Pete, I have a question, "The jobs report showed much greater growth than was expected and this means that the Fed will not cut interest rates for a long time. Those high interest rates are going to choke off the economy. Consumer debt levels are at all-time highs and default rates are rising. The yield curve is inverted and that has lead to a recession 100% of the time. An analyst who correctly predicted the 2008 financial crisis sees deflation on the horizon. That would cause a big market drop. Would this be a good time to buy longer term put options?"

Pete, I have a question, "XYZ just announced better than expected revenues and earnings and the stock is tanking. It trades at a lower forward P/E than other semi conductor manufacturers. I have their chips in one of my computers and I really like them. The stock has broken major support levels in the last two days so the IVs are high. Is this a good time to sell an out of the money bullish put spread?"

Pete, I have a question, "Elon Musk said that AI is going to eventually replace all workers. People will lose their jobs. When that happens there will be millions of people out of work and crime rates will go up. Is this a good time to buy Smith & Wesson Brands as people buy guns to defend themselves? Would it also be a good time to buy Callaway since they will have more time to play golf?"

If I had a nickel for each of these I would be rich. I've tried to figure out why people do this. In some instances the person is clueless and in some instances the person is incredibly smart. This trading mistake spans the intelligence spectrum so it does not explain this behavior. I've concluded that there are many reasons and here are some that might explain it.

Outsmarting The Market

The trader forms a market opinion and then they zero in on every article that conforms to their forecast. They will cite experts who correctly forecasted a major market move decades ago. It doesn't matter that the expert has been wrong since then, only that they were right once and that they agree with what the trader believes will happen now.

People feel like they are smarter than the market. The big money just hasn't figured out what I know so I will beat them to the punch. Some of these people might have some industry specific knowledge, some of them might have an MBA and some of them might just feel they know "everything."

Listening To "Gurus"

Some feel that "Guru Lou" is smarter than the market. He is an analyst for a big firm. He looks good on TV and he sounds smart. He was right on crypto and now he thinks AI is cheap. These followers latch on to a theme that resonates with them and then they pile in regardless of what the chart is telling them. I've seen scores these "gurus" come and go since the 1987 crash. They got one moment right, they built a reputation on that one moment and they have been wrong ever since.

Dogmatic Traders

Some traders want to justify holding on to a losing position. They bought marijuana stocks when they were "hot" and now the bottom has dropped out. "That's OK, people will want to smoke pot and this company will do great when other states legalize it." They don't take into account that many growers and distributors are entering the market and that profit margins are declining. They also don't account for the fact that people can legally grow it in their homes or that there is still a black market for it. All they know is that they like smoking pot and that these stocks should do well. If they had just paid attention to the charts, they could see that the selling pressure was heavy.

Contrarians, Optimists & Pessimists

Some traders can't join the trend because the stock or the market is "over-extended." They lack the confidence to buy a new high and they just feel that as soon as they do, the bottom is going to drop out. Consequently, they search for reasons why this is a bad time to buy.

Some people want to make a killing on the next trend reversal. They are not going to be "the last person standing when the music stops." They are not going to follow all of the "lemmings." These same folks will take the other side of any conversation and they will debate everything. They are contrarian by nature. If you say black, they will say white.

Some people are born pessimists or optimists. The pessimists are called "perma-bears" and they are always looking for "Black Swan" events. The optimists are called "perma-bulls" and there is always a "silver lining." The 100-year chart tells us that it is better to be an optimist, so error on that side if you can control this disposition. Long-term, optimists will be on the right side of the market if they give themselves enough time and they will generally live happier lives.

What about; the war, inflation, credit, AI, the internet, the election, a flash crash, PIIGS, illegal immigration, global warming, cancer, the debt ceiling, the bond auction, Chinese real estate, Iran going nuclear, shipping in the Red Sea, moly supplies, crypto, the union strike, the electric grid getting hacked, the decline in US literacy rates… the list goes on and on.

The Market Is Always Right

So what's the solution? You need to realize that the market is always right and that you don't know "Jack." I started The System off with a look at fundamental analysis and why we can't compete in that arena. Technical analysis is pure and it doesn't lie. Price and volume reflect what the smart money is doing and our goal is to follow them. If anything we've discussed above plays out, we will see it in the price action. If a bear market trend is going to reverse, we do not buy when the market is still going down. We don't even buy the first bounce because that could simply be a short covering bounce that will turn into a bearish flag and result in a new low. We wait for a tall bounce with long duration and then a higher low double bottom. Then we can start looking for a bearish trend reversal.

It's important to read and to understand what is influencing the market. I conduct fundamental analysis and I encourage you to do the same. Be aware of what is happening around you, but follow price. If your suspicions are correct, you will get technical confirmation and then you can act.

Let me give you an example. In January of 2020, I started reading about how China was shutting down during their busiest time of the year (New Years). The second largest economy in the world was in a lockdown. This virus was serious and it had the potential to spread quickly based on the intense reaction by the Chinese. I wondered why the market was discounting this news. The market was at an all-time high and based on this development, we started to reduce our long positions. We missed that last leg of the rally and it continued well into February. I felt foolish at the time because I was overly cautious. I did not short based on what I thought was going to happen. If I had, we would have lost money and we would have been shaken out of those bearish positions. At the end of February 2020, I saw a very nasty round of selling and we exited the only bullish position. We did not short until we had a technical breakdown the following week. We waited for that confirmation and evidence that the "smart money" was reducing risk.

The market is always right. It is the ultimate discounting mechanism. Trade what you see and not what you "think." People who feel that the market is wrong will be humbled. They will lose a lot of money and only then will they grasp the importance of this lesson. Some will learn to respect the market and they might have a fighting chance to learn how to trade. Others will conclude that the market is "broken." They will continue to "outsmart" the market until they run out of money.

Chapter 13: Stay Engaged And Be Productive

If the market is dull, keep yourself busy. The work you do now will set you up with future trading opportunities.

There are about 250 trading days during a calendar year and half of them are dull. Learning how to identify low probability trading environments (LPTE) is important and we have to handle them with care. Choosing not to trade them is typically best, but that does not mean that you sit around idle waiting for a trade to fall into your lap.

Search For Opportunities

Great traders are always searching for opportunities. They are flipping charts in search of a trade. Even though the market is not doing much, a particular stock or a group could be "hot." These stocks won't have a market tailwind, but they won't have to fight a market headwind either. If the checkboxes are marked, great traders will size down and make money on a nice opportunity that lazy traders missed. During the process, they will spot key price points for many stocks (trendlines, horizontal support and resistance, gaps…) that might not be in play now, but that will be in the future. They take time to draw alert lines or to set alerts that will trigger when technical indicators confirm the move. When market conditions improve, they will get alerts left and right at those key price points.

Even if the day is not conducive for day trading, there could be potential swing trades that are attractive. If the market has been in a strong uptrend, you might be looking for longer term ITM calls to buy. If the market has been in a trading range, there might be some nice bullish put spreads that you can find.

Try New Ideas

Experiment and try new ideas. Perhaps you have been using an alert variable with a particular time frame. See if another variable or time frame might work better. Set those alerts and see what happens. Create new Custom Searches. Why might this search be better? Are there market conditions where this search would be particularly useful?

Work On Your Game Plan

Game plan for the week ahead. What are the scheduled news events that might impact the market? How has the market reacted to these releases previously? Are there any big earnings releases? Do you have positions in any of those stocks or a position in a company from that group? Do your positions need any adjustments? How will you be positioned into that news? What is the worst case scenario and how will you react?

Review Your Trade Logs

Review your trade logs. This is tedious work and after a long day of trading, sometimes you don't have the energy/interest to do it. I prefer to do it after the close when the trades are still fresh in my mind, but there is no harm doing it during normal trading hours. What did you do well? What did you miss? Is there something you can improve on?

Study Price Action

Study the price action of SPY M5 and 1OP. In Option Stalker Pro on M5, you can hit the Home button on your keyboard and it will send you back in time. Click forward bar-by-bar until you hit an inflection point or a key bar. What did the price action up until that point tell you? Should you be expecting a reversal? Take a stand and then click forward to see if you were right. No peeking.

Look For News

Look for news sources that you can use during your pre-open market analysis. I prefer raw news so that I can read the article and draw my own conclusions.

Spend Time Learning

Read books, the WIKI, The System and watch trading videos. Search the OneOption archives. They are packed with lessons from the chat room. A team of members collect those lessons and you will find some real "gems." There is always something to learn.

Stay Out Of Chat Rooms

Stay out of chat rooms! Of course, the OneOption chat room is the exception because we don't allow casual conversations. Our goal is to only post information that is going to help you now. If you are posting to chat rooms, you are not focused. Who are the people you are communicating with? Are they in a position to make you a better trader? Will they be around in a year? Chances are… no! Good traders are focused on finding great trades, especially during market hours. They are not posting in chat rooms. If there is someone that you really respect as a trader, I will bet you that they don't post much during market hours. I know that trading can get lonely at times, but you can go into those rooms after hours to get your "social fix." If you are in these rooms when the market is moving, you will never make it as a trader. Your entire focus should be on finding trades and managing your positions. Time spent debating with "FOMO Joe" on which indicator is better is time wasted and you will never get it back.

Trading is a tough profession. It is not something that you can ever perfect. Pros are constantly looking for new trade ideas, new methods, new sources of information and ways to improve their performance. If you are passionate about trading, no one will have to motivate you to do all of the things I’ve mentioned. You will do it on your own and a few hours after the close of a dull day, you will wonder where the time went. Stay engaged!

Chapter 14: The Flip-Flop Trader

Your opinion on direction should be rock solid and it should rarely change.

When you form your market opinion on a D1 basis, it should not change like the wind. This is longer-term analysis and it does not change very often. If you are bullish, you know the type of price action that would change that opinion and you know the technical support levels that would have to be breached to change that opinion. The same is true if you are market neutral or bearish. As directional traders, we are looking for stocks that have a strong trend and momentum. The price action is undeniable and we have a firm directional opinion for the stock. If you don’t have an extremely high level of confidence in the direction of the stock, keep looking. There are thousands of stocks and there is always a great long or a great short – never compromise on the stock.

Neutral Market Bias

Let’s take the most difficult scenario where you are market neutral. The market could be compressing in a longer-term horizontal trading range or it could be extremely volatile with big swings both ways (typical during a trend reversal). The price action could be difficult to read and you don’t have a directional bias for the market. Given that this is the biggest puzzle piece, you keep your size small and you reduce your trade count. You are market neutral and this is reflected in your position sizing and risk exposure. While the market is searching for direction, there will be stocks that are tanking (relative weakness) and stocks that are flying higher (relative strength). We might carry a mix of longs and shorts because we are market neutral, but when it comes to the direction of the stock, we do not waiver. All of the checkboxes are marked and it would take a considerable contra move in the stock to change our opinion.

What Would Make You Bearish

Let’s say that a stock is in a very strong uptrend. It has been making higher lows, it is above all of the major SMAs, it has relative strength, it is above AVWAPE, it has heavy volume and it has just broken through a technical resistance level. It is the “strongest of the strong.” All of these checkboxes tell us that institutional buyers are active. Would a two week compression turn us bearish on the stock? No! That is just a resting point in a strong move higher. Would a handful of red candles on heavy volume turn us bearish? No! That is just a normal round of profit taking. We want that dip to be brief and shallow. Then the stock is likely to regain its strength and form a D1 bullish flag and stage the next run higher. Would a lower high double top get us bearish? No, but that would get us neutral if the market was stable. This is a sign of resistance and in a stable market, we expect to see the stock to grind higher and to take out a relative high. The bottom line is that it is going to take a long time and some heavy selling pressure to turn us neutral and it will take even more to turn us outright bearish. The chart below is a strong stock.

If the market broke a key technical support level and that is why the stock made a lower high, we could still preserve our bullish bias. On a relative basis, the stock might still be strong and as soon as the market finds support, the stock will power higher. If the market was relatively stable or even strong and the stock made a lower high, that would cause us to be neutral on the stock. That is when we expect the stock to move higher.

If the breach of market support has changed our market opinion, we need to lighten up on our long stock positions across the board. It would be natural to start by exiting the stocks that are showing the most sensitivity to the market drop.

Notice that all of this analysis has taken place on a D1 basis. That is what we lean on the most. However, this same analysis for the market and the stock continues on an M5 basis. Don't make the mistake of only doing your analysis on an M5 basis. Everything starts with the longer term chart and then it drills down to the M5 for short-term traders.

Why Traders Flip-Flop

So where does the flip-flop trading come into play? It is typically the result of changing market conditions, poor analysis, a lack of confidence, reliance on one or two indicators and/or a desire to trade a particular stock. I love it… buy, I like it… buy more, I don't like it… stop out, I hate it… short. You need to avoid this state at all costs. It is a mental mind f___. You have no clue of what the market or the stock are going to do and you are just reacting to the last move. This is a great way to blow out an account and to destroy yourself emotionally.

Changing Market Conditions

Let's start with the market. Remember, we are taking the most difficult scenario where our market opinion is neutral. In another article I discuss the contra trend trader. When our market opinion is neutral, we need to trade smaller size and we understand that we will not have that tailwind helping the position. The stock has to do all of the work so it is likely to have fits and starts along the way. In the example above if the stock made a lower high and if it was market related, it does NOT mean that this stock is a good short. You would not flip from bullish to bearish on a stock if the weakness is market related. You would temper your bullishness and you would exit. This is a strong stock and the long-term buyers are not going to bail just because the market is temporarily weak. When your market opinion changes, you find stocks that have been weak and that have all of the bearish checkboxes marked. You do not short the strong stock you've been long on the notion that massive profit taking is going to set in and that the stock is going to give back all of its recent gains. There is no technical proof that is going to happen.

Poor Analysis

Poor analysis is a deep seated problem. The trader spends a minimal amount of time conducting market analysis. They don't have a market opinion or they have a flimsy basis for their opinion. By the way, the entire first section of this course walks you through the process of how to form a market opinion technically and fundamentally. The stocks they select are marginal and they do not have all of the checkboxes marked. These traders are simply chasing "hot" stocks and they are reactive, not proactive. They don't have a game plan so all of the moves seem random. If everything is random, they feel they need to be flexible and it is only natural to trade both sides of the same stock.

Lack Of Confidence

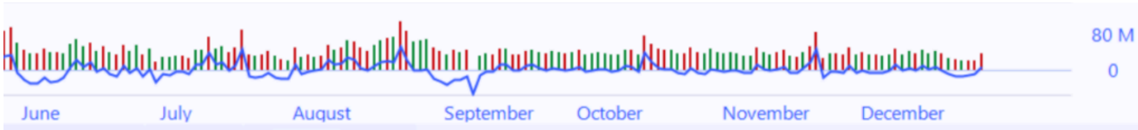
A lack of confidence is another reason traders flip-flop. This is particularly true for traders who are just starting out. They have a basic understanding of technical analysis and what they should be looking for, but they are still not profitable. They are second guessing themselves constantly. They chase an entry and the position is up a little and they are happy. Then the stock tanks, but they are not surprised. Some are even position is up a little and they are happy. Then the stock tanks, but they are not surprised. Some are even expecting that to happen. They feel like they are always wrong. “If I want to make money trading, I should just do the opposite of what I think.” So they short the stock.

Over-Reliance On Indicators

Some traders fall in love with an indicator or study. They don’t have any other checkboxes. The stock rallies above the 100-day SMA… buy, buy, buy. The stock dips back below the 100-day SMA… sell, sell, sell. When it comes to indicators, they are backwards looking. Often by the time an indicator has triggered a signal, the move is over. That is why the we lean on a number of different indicators across multiple time frames. Each is one of many checkboxes and each indicator should measure price action differently.

Desire To Trade Particular Stocks

Some traders fall in love with a stock. Nvidia is a great example after a huge run higher in 2023. NVDA… NVDA… NVDA. These traders have tunnel vision. It is all they can think about. If the stock has liquid options, it is sure to be a hit. These traders are going to try and time every random wiggle and jiggle while the stock is trapped in a range. I love it… I hate it… I love it… I hate it. There is no rhyme or reason to these moves and the trader is going to get chopped up. The fact that the stock is trapped in a trading range and that the price movement is choppy is a clue that institutions are indifferent. There is no prevailing trend and your ability to predict the next move is practically zero.



Review Your Checkboxes

If you find yourself flip-flopping… **STOP!** Something is broken. This activity is going to destroy your confidence and your account. The first place to look is the market. Has it become more volatile? Has it breached a key D1 price level? Did you miss that piece? Even if the market is neutral, you should still be able to find great stocks. That is the second place to look. Perhaps you are not picking the best stocks. We need nice orderly price action and lots of D1 checkboxes marked. If you have that, it is going to be very difficult for all of those checkboxes to pivot. I have scores of articles on the types of price patterns we look for. Typically, a very strong stock will go from bullish to neutral before it becomes bearish. Do not fall in love with a stock that does not have a strong trend. You can't predict the next move and that is how we get paid. If you are nervous because you just started trading, paper trade. In time your skills will improve. If you try to trade before you are ready, you will lose your hard earned money and you will damage yourself emotionally.

During the life of a trade, doubt will surface. The market won't look quite as strong and the stock will waffle. What looked like a slam dunk might not look as promising after you enter. That is when you review your list of market and stock checkboxes. You were confident when you entered the trade. What changed? Often nothing changed, you just needed that reminder and now you are prepared to weather the wiggles and jiggles. If you had many checkboxes marked, your confidence remains high. If you only had one or two checkboxes marked, your confidence is low.

Chapter 15: Heads Or Tails?

Many traders trade binary events. They don't want to learn how to trade, they just want to gamble.

A seasoned trader that sticks to this system can reach a win rate greater than 75%. A binary event has a 50% win rate. Why would anyone settle for those odds?

A binary event is a scheduled news release that is going to have a major impact on the price of the stock. It will either be "good" or "bad." The most common binary event is an earnings announcement. Stocks make gigantic moves after reporting quarterly results and these will be some of the biggest moves on a chart. There's nothing like the thrill of taking a position and then waiting for "the number." I know, I've traded plenty of them. I spent years trying to find a method that would work. First I played "Junior Analyst" and I put on my "fundamentals hat." I looked at the earnings trends and I gathered information on guidance revisions and analyst upgrades and downgrades. I looked at the guidance from competitors who had recently released and I monitored the reactions to those releases. There's nothing more frustrating than getting "the number" right and then watching the stock tank. Perhaps there was a "technical" clue. I studied price patterns before the release and I used proprietary indicators to see if they might provide a clue. I analyzed charts to see if a big reaction either way might produce a major technical breach and fuel the move in that direction. I gathered information on option open interest (calls and puts) and implied volatilities to see if there was a bias. Perhaps the size of previous reactions compared to the previous expected moves (the cost of a straddle) would provide and answer. During this evaluation, I tried every options strategy you can imagine. Here are my conclusions.

Trading Earnings Releases

You can't predict the direction or the magnitude of the earnings reaction. Every major institution is running their models and I can't compete. They have better information than I do. They know every little component supplier for iPhones and spend millions of dollars gathering data. They also see much of the order flow as an executing broker for large funds so they know the bias. All of the time I've spent analyzing upcoming earnings releases and all of the time I've spent managing the positions after the release was a waste of time. I was able to produce slightly better than a 50% win rate. If I spent that same amount of time finding normal trades, I could make a lot more money with much higher odds of success.

I can trade the stock before the earnings announcement and I collect data on stocks that have a tendency to rally (drop) ahead of the release historically. We also trade the price action for stocks that are about to release earnings. After the announcement there are plenty of opportunities to trade the stock. I have a study called eReaction that shows the price action on an M5 chart for the last four quarters immediately after the release to see if there are any patterns on a major gap up or down. I also have post earnings searches that track the stock's performance since the release. Often, the initial reaction is a head fake and the stock's true colors are not revealed for a few days. We also calculate and display AVWAPE. There are plenty of opportunities with excellent odds before and after the number.

So why do people trade earnings releases? Because it is exciting and because they think they are going to hit a big winner. There is very little research conducted by most earnings traders. They have a "hunch" that the stock is going to go up (or down). Little do they realize that the option premiums are sky high. There is uncertainty surrounding the stock heading into the announcement and Market Makers are pricing in a big move in either direction. Here's one of my favorite conversations. "Pete, if I buy a call option and the stock goes up the next day, isn't the price of the call supposed to go up?" I have learned to respond with my own question, "Did you buy calls on a stock that was reporting earnings overnight?" "Yes, how did you know?" Even if you got the direction right, you will often lose money on earnings trades because the move is not "big enough." If you got the direction wrong, you will be crushed like a little bug.

"Pete, just because you couldn't make money trading earnings reactions doesn't mean that I can't find a system that works." That is very true. Go for it! Plan on spending years building, testing and perfecting your system. I will avoid binary events and I will keep trading a system that I know produces consistent results. I've traveled the "earnings road" (and many others) to get to find the one I am on.

Other possible binary reactions include clinical trial results, new product releases, investor conferences and lawsuit verdicts (i.e. patent infringement). The Market Makers are aware of these events and the options implied volatilities will be sky high.

Market Related Binary Events

There are also market related binary events. The FOMC Statement is released eight times a year. This is a major news event because it is when the Federal Reserve raises and cuts interest rates. When the Fed is in a holding pattern, it is less significant. During 2022, the Fed was on the most progressive rate hike I've seen during my career. They were trying to fight inflation and these dates were important. During the Financial Crisis of 2008, these statements were also very important because the Fed was trying to prevent a collapse. From a trading standpoint, you adjust risk ahead of the release if you feel that it could have a major market impact. If you feel that the news will not have a major market impact, you stick with your current positions and you mentally prepare yourself for the worst outcome. You determine what type of reaction might prompt you to adjust your risk. You also prepare yourself for the best outcome and you determine if it would be prudent to add to your positions if it plays out. Major economic releases can also move the market. The biggest one is the Unemployment Report and it is released on the first Friday of the month.

For the most part, binary market events are not that damaging. If you feel the reaction could be significant, plan around it. Avoid binary events for the stock. The time and effort you spend trying to predict the outcome can be better spent on normal trades. Leave earnings trades to the gamblers who have a "hunch." Consistency is the name of the game and you won't find it trading earnings releases.

Chapter 16: "FOMO Joe" Knows It's Going Higher

Novice traders are easily excited. The opening bell just rang and the "casino" is open for business. They look for "hot" stocks and they "know" this one is going to run. Don't trade with this crowd.

Most people start trading to find "fame and fortune." They've read a few books or watched a few YouTube videos and they are anxious to get started. Perhaps some co-workers have boasted about how much money they've made buying call options. Their expectations are "sky high" and they think "this is going to be fun."

They haven't put in the work, they are just going to dive right in and start making money. They convince

They haven't put in the work, they are just going to dive right in and start making money. They convince themselves that, “Everyone on Discord has more experience, so it’s “best” to just follow those trades.”

These traders will chase a stock that is stacking green candles on the open. They don’t care why the stock is up, they just want “some of that action.” These stocks are typically your big tech names that get a lot of press. Nvidia is a perfect example. The stock rallied from $108 in October of 2022 to $975 in March 2024.

This week, bullish speculators have been piling into it so I thought I would write about it. This was a colossal display of stupidity. They were buying weekly call options that were $200 out of the money and that would expire in a few days. My intent during this article is to do everything I can to discourage you from ever trading with this “gang.” I want you to know when you might be doing that and I want you to feel embarrassed when you “run with them.”

Nvidia is a tech giant that makes computer chips and “FOMO Joe” heard they were hosting a conference featuring their new Artificial Intelligence (AI) products. This time he actually did a little homework. The stock gapped up and he was frothing at the mouth. It’s the first day of the conference and “this baby is going to scream higher.” He’s not going to wait, he is going to buy calls right away. Surely Nvidia was going to announce some great new products.

Here are my comments from the chat room Monday morning with the time stamps. I started commenting 10 minutes after the open when the stock was still at its high for the day. This was so perfectly set up for a giant fail, it was like watching a train wreck in slow motion.

Pete — Mar 18, 2024, 8:42:20 AM

"FOMO Joe" is very excited this morning. He heard that **NVDA** is going to speak at an AI conference and he just knows the stock is going to run. Be very careful joining him. We want him flushed out. Then there could be a play. Don't overstay your welcome. These are often "sell the news" events.

22

Pete — Mar 18, 2024, 9:34:00 AM

"FOMO Joe" is angry with himself. He did it again and he wishes he had held off on buying **NVDA** on the open. He thinks, "That's OK, the market is strong and it will come back."

14

Pete — Mar 18, 2024, 9:37:39 AM

Tomorrow he will ask, "I don't get it. **NVDA** had RS M5 so I bought it. Then the stock went down. Why does this happen? I thought it was supposed to go up because it had RS M5."

11

Pete — Mar 18, 2024, 10:09:47 AM

"Don't people know that **NVDA** is going to present at the GTC AI Conference? Why is it selling off?" I told you this was likely 10 minutes into the open when the stock was making a new hod. The institutions know how you think. They will let you come in and buy these stocks knowing that they are going to slam the door in your face. Of course they are aware of the conference.

19

Pete Mar 18, 2024, 10:13:58 AM

The institutions also know that these traders have very little staying power. They can see it from the order flow and they are expecting this on the eve of the conference. They welcome these bullish speculators and they know they can easily be chased out. "This is unfair! This is market manipulation! This should be outlawed. How is the little guy supposed to compete with large institutions.

16

Pete Mar 18, 2024, 10:15:02 AM

If you want to make money trading, you have to start thinking like the large institutions and you have to stop thinking like the fool who bought **NVDA** on the open.

24

The option premiums were sky high. “FOMO Joe” paid through the nose for those options. He dove in thinking he might buy some more if the stock keeps going up. He’s not worried about what he might lose, this company is going to announce some great new chips and it’s going higher. He is completely motivated by greed. The stock peaks after 15 minutes of trading and it starts to retreat. He’s not worried, this is just a small pullback and he is going to give it plenty of room. The stock continues to pullback and it drops below VWAP. That’s OK. “FOMO Joe” doesn’t know what that is. The stock takes out the low of the day and he starts thinking that maybe he rushed the gun a little bit. Within two hours of trading, he has been completely fleeced and the stock pulls back $50. In the chart below, you can see how the stock was flat (blue line) on a D1 basis and the options IVs were rising. The Market Makers knew that bullish speculators were buying these calls. They had been doing so the previous week. The premiums were very expensive (the odds of the bullish OTM call buyers making money was low). "FOMO Joe" thinks he's the only one who knows about this conference and he is going to make a lot of money. By the end of the day, he's not thinking about that new motorcycle. He's thinking about how hard he had to work to make the money he lost in a couple of hours.

He doesn't understand where he went wrong. All of his call buying buddies in Discord got punished as well. The lesson he probably learned was not that he's a fool. Oh no, that could never be. He learned that the market is rigged against the "little guy" and the Market Makers manipulated the market. They that the market is rigged against the "little guy" and the Market Makers manipulated the market. They lured him in and then they forced the stock to drop. If this is what he learned, that is a good take away. If you want to make money trading, you have to stop thinking like "FOMO Joe" and you have to start thinking like the institutions. That's what this whole course is about.

If you EVER suspect that you might be trading with this crowd, do this before you enter the trade.

1. First you should relieve yourself. You'll know why in a second.
2. Go into your sock drawer and find a pair of socks. No, not the thin nylon dress socks, you will need the thick "woolies" you wear in the winter for this.
3. Place one sock over each hand. If you live with someone, ask them to secure them tightly by wrapping duct tape around each wrist.
4. Good. Now you can't place a trade using your keyboard. I'm sure some people will figure out a way, but it won't be easy.

Nvidia was an obvious "train wreck" and here are some of the other set-ups where you need to be careful. "FOMO Joe" lives on the corner of greedy and stupid so he's pretty easy to find.

Gaps Up Through Minor Resistance

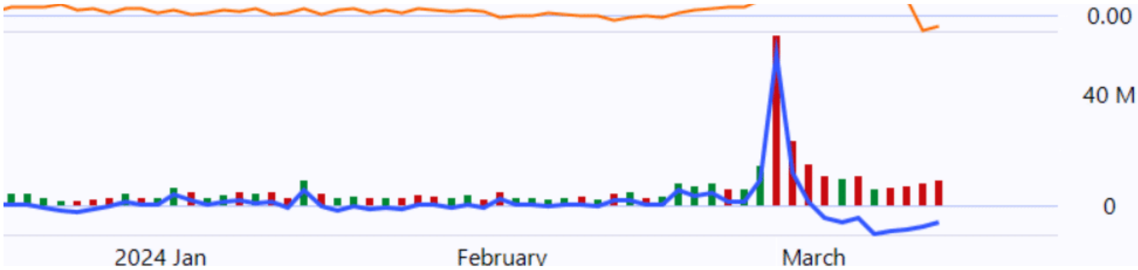
"FOMO Joe" is going to be busy in the first 15 minutes of trading buying SPY calls at a new relative high. The D1 chart for the looks great so he piles in. He doesn't know why the market is up and he doesn't know if the gap up is going to hold. All he knows is that this train is about to leave the station so he climbs aboard. If the market is gapping through a minor technical resistance level (20-day SMA or a 5-day high) the move might not hold. That is a resistance level and sellers will be close by. Once "FOMO Joe" is in, the institutions will play "Whack-a-mole." This is a key price point and what looked like an obvious breakout suddenly transforms into an obvious rejection. "FOMO Joe" gets worried and he takes the loss. This is why we need to wait for confirmation. Remember, most gaps up are tested and many result in a gap reversal. This is not a good risk/reward profile for us.

This same concept applies to stocks, except it's more common. It is easier to move a stock than it is to move the market. This is minor resistance so it is easily breached. Stacked green M5 candles will excite traders especially when the stock is through a resistance level. Set alerts and try to buy dips. Often when the alert is triggered, the stock will have pulled back below the breakout. The drop will be deep and you will recognize that the initial breakout was a head fake. Mistake avoided.

Gaps Up Through Major Resistance

If the market gaps through a major resistance level (100/200-Day SMA, horizontal resistance, or a trendline), that is a bit more convincing because it's harder to do. Some of that early move could be fueled by a short squeeze as institutions adjust risk. We still need to wait for follow through. Perhaps that breakout will be preserved, but there's a chance that some of the gap will fill. That will confirm that buyers are interested and then we can join the move with confidence. If the market holds the gap up with little to no retracement after an hour of trading, we can feel confident that the breakout is legitimate. We want to see a steady grind higher on heavy volume and it helps if there has been a catalyst (Fed, earnings or economic release).

Stocks that gap up through major resistance levels are fueled by news. Something has changed. Most frequently, this is due to an earnings release. There is new information that will impact future earnings. It could be that the company "guided higher" or perhaps there was a successful clinical trial. Regardless of the news, we need to make sure the reaction was legitimate. We want to see the stock hold more than half of the gap up before we start to trade it. Ideally, the stock compresses near the high of the first candle that created the gap. There will be profit takers who bought before the gap and they will take gains. That supply needs to be exhausted. Buyers are interested and that is why the stock is not retracing. This is a sign that the news was "good" and it was well-received. Eventually, buyers will get more aggressive and the stock will move higher. You don't need to be "FOMO Joe." Many of these moves reverse. Wait for confirmation.



Grind Through Major & Minor Resistance

You are probably "catching my drift" at this stage. We need confirmation. Let's talk about breakouts in general. Often the stock will not gap up through resistance. It will gradually work its way towards it and it will poke through it. Now it's on everyone's radar. We don't make money on the breakout, we make money on the follow through. Just because the market or the stock breached a resistance level, there's no reason to believe that the move is going to hold. Remember, we don't rush to judgement before the candle has completed. A nice long green candle through resistance often turns into a bearish hammer when it completes. This is a resistance level and we know that sellers have been active here before. "FOMO Joe" believes that every breakout is going to hold so he does not wait for confirmation. The key to this set up is that the move through that resistance level takes place in a nice orderly fashion. Once the market/stock are through that resistance level we want very few dips that retest the breakout. When we do get those dips, we want a strong and instant bounce. We don't want to linger around that level, we need "escape velocity" from that prior resistance level. It will initially act as a magnet. If the move quickly gains traction, the price action is steady and the volume is heavy, we can take starter long positions. We only add to the position when the orderly price action continues. The dips (if there are any) are brief and shallow.

Bottom Picking

This is a nasty habit when it comes to personal hygiene and it is also a nasty trading habit. Did you think "FOMO Joe" only buys breakouts? Oh… no… no… no. He is also "the guy" who is going to scoop everyone else. He's heard that the key to trading is to "buy low and sell high." When the bottom is falling out from a stock on a D1 basis, he recognizes "value" before everyone else. He is going to "beat them to the punch." All he can think about is how much money he's going to make when the stock recovers.

When we have sustained directional movement, a trend forms. We never assume that a trend is going to reverse until we have well-established support, a higher low and a technical breakout to the upside. The more pronounced the decline, the longer it will take the market/stock to establish that support. Sellers are aggressive and we can tell that from the price action. In a strong down trend, there will be bounces. Each of these will excite "FOMO Joe" because he wants to be early. In the chart below, the trend is clear. This is a nice orderly decline and this is a bearish trend day. If it is taking place in a longer-term D1 bullish up trend, there is no need to enter bullish trades. This is a day where you sit on your hands. "FOMO Joe" will be anxious to get long. Every little bounce will represent a buying opportunity. In the chart below I drew in a classic set-up. The market bounces and there is a long green candle through VWAP. Eureka! "This is the move we've been waiting for!" Do you think this move would excite "FOMO JOE"? Of course it would. He is not going to wait for confirmation… that would be too late so he buys immediately. That long green candle would be erased immediately and the next leg lower would start. This is such a classic set-up.

One of the keys to trading is to remain calm. Plan your trades and don't act impulsively. If a big move is underway, our risk is elevated and we need to make "double sure" that it is not going to reverse. Find out what's driving the price action. In most cases there will be a dip. We want it to be brief and shallow. If we don't get that, there will at least be a compression. We can buy that breakout as well. The fact that the market/stock has been able to preserve all of the gains tells us that buyers are aggressive and that sellers are not able to put a dent into the bid. There will always be an opportunity to join the move. Not all of them will be legitimate and you will be glad that you did not "bite." Know that sometimes (rarely) you will miss a trade because you are being patient. Be OK with that.

We need nice, orderly price action on heavy volume and we need that "escape velocity" from the breakout. We don't lunge, we take starter positions and we add on confirmation.

When the stock has made a huge move and when it is generally "newsie," we have to be particularly careful. You are not going to "pull one over on Wall Street." Big moves lure in the unsuspecting and they are often fake. Is there news to justify the move? If not, it is a technical breakout and the likelihood of a dip or a reversal is higher.

Don’t buy big drops that have not confirmed support over a long period of time. The bigger the drop, the longer it will take for support to form. We need to see double bottom higher lows and a breakout above technical resistance before we can start looking for a trend reversal.

Think about who might be excited by the current move you are observing. If there is the slightest chance that “FOMO Joe” is embracing it, don’t take the trade! Then you will be able to keep your socks in the drawer.

Chapter 17: Think In Terms Of Cycles

Novice traders tend to think in linear terms, but that’s not how the market moves.

When traders put their business plan together they know how much they need to “cover” their bills and to have a little left over. Let’s say that number is $500/day. In their mind they need to make that every day and when they don’t, they get nervous. They start forcing trades in a low probability market and they lose money. It’s like “Chinese water torture” when the market has no pace or direction. Stocks breakout and you have confirmation that the breakout is holding, so you buy. Unfortunately, there’s no market tailwind to fuel the move so the stock retreats leaving you with a small loss. Now it’s even harder for you to hit those daily goals. If you lose $500 in a day, the next day you have to make $500 to get back to even, you have to make the $500 you didn’t make the day before and you have to make the $500 you need for today. You have to make $1500 just to get back on track and you can see how a small losing streak can quickly get you in “the hole.”

The Market Ebbs & Flows

Here’s the problem. The market doesn’t move in a linear fashion. It has ebbs and flows and we can see that in the price action on a D1 chart. You need to think more like a professional Black Jack player that counts cards. When the odds are low, they keep their bets small. When the odds are high, they increase their bets.

Instead of thinking that you need to make $500, $500, $500… start thinking that the actual pattern will be more like $0, $0, $1000, $2000, $500, $0, $0… The market moves in cycles and not in a straight line. You need to sit idle when the odds are low and you need to strike when the odds are high.

How Many Decent Trading Days Per Year?

There are 365 days in a year. We need to remove the weekends (104 days) and the 10 exchange holidays. Holidays typically result in dull price action the day before and the day after so we can remove another 20 trading days. We have 8 FOMC meetings a year so we can remove the day before the Fed meeting and the day of the announcement. We also have at least 1 major economic release a month (typically the focus is on the Unemployment Report). That removes another 12 days a year because the action the day before is usually dull. The week between Christmas and New Years is slow. The middle of August is typically dull as well. People take vacations before the kids go back to school, the Fed is in recess and so is Congress. So now there are another 15 days that we can remove. We are left with 188 days out of the year. The number of possible days when we can make money day trading has been cut in half. I haven't even accounted for major holidays in other countries or bank holidays (they impact our volume). If the market has a large move the prior day, the next day is likely to be dull "inside day." If the market is not trending, there will be many low probability trading days. When you look at a chart, look at the number of days when the candle bodies are long and the number of days when the candle bodies are tiny. At most, I believe there are 150 decent trading days a year and that number is probably closer to 120 trading days if I'm being honest.

This is very disappointing when you think about it and it frustrates the heck out of traders who are trying to make $500 a day. So what's the solution?

Trading Futures vs RS/RW

First of all, if you are day trading /ES (S&P 500 futures) or /NQ (NASDAQ futures), you are scalping. Most days the volume is low and the intraday range is compressed. The price action is very choppy/sloppy because most of the activity is driven by trading programs. There are professional /ES traders, but this is a very tough way to make a living. I know, I've gone down this path so I speak from experience. I still trade /ES, but only on trend days to give myself an extra "kicker" (size up when the odds are high). I'm not going to write an article on this. Just know that it is a very easy way to increase your exposure and you can gain a lot of leverage with /ES. I might get a few of these a month. For all other days, keep in mind that institutions trade /ES. The liquidity is excellent and they need to trade "size." We are the "little guy." Why do we need to compete on their turf? We don't have to. We have our own advantages so we need to make use of them.

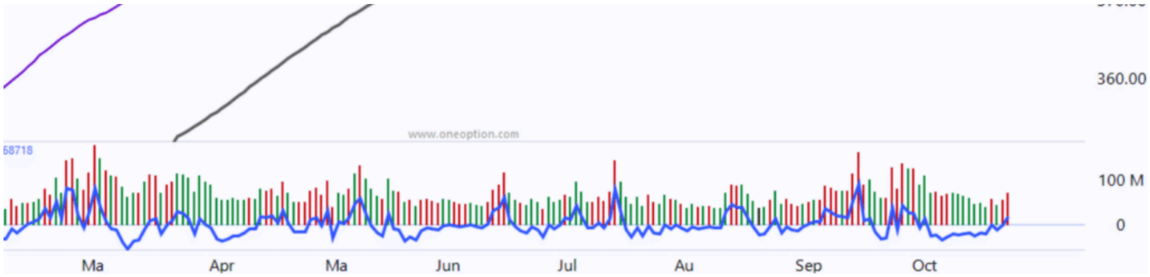
When the market is not giving us much to "look at," there are always stocks that are moving. We have thousands of stocks to trade and the patterns are fantastic. If we can make money trading 1000 or 5000 shares, it can provide us with a great income. Institutions would not even consider these trades because they are not "big enough." We might not have a market tailwind most days, but we don't have a headwind either. As long as the price action (D1 and M5) is tight and orderly and the volume is good, we have a candidate. During the day, we can time our entry/exit based on SPY movement using 1OP. Ideally, the stock is on a mission and it is oblivious to the market. That is a sign that longer-term institutional money (funds) are buying it. In those instances we try to "ride" the move. When we don't have that market tailwind, we trade smaller size. We can still make money, but we have to lower our expectations (set passive targets). We can also watch for sector rotation. There will be days when nothing looks good and where it is impossible to find a stock that is trending. It happens and you need to be able to walk away. This is when you spend the day placing alerts. Keep busy and set yourself up for future moves, but don't trade. By trading stocks (and not /ES), we've recovered many of the days when there isn't much market movement.

There will be trend days when all of the "tumblers" are aligned. The SPY D1, the SPY M5, the stock D1 and the stock M5. Everything on the "menu" looks good. This is when you have to strike as a day trader. You might only get a few trend days a month. They can start out as a dull "sleeper" and gradually gain momentum. Watch for a steady grind higher with little to no retracement. Just because a day starts out dull, don't assume it will stay that way. Keep your focus and stay engaged. Your starter positions will be performing and you will be able to add on confirmation. As the day unfolds you will recognize the strength. This is when you have to strike so make it count.

Swing Trading

Another way to smooth out your performance as a day trader is to swing trade. There will be times when swing trading is more effective than day trading and vice versa.

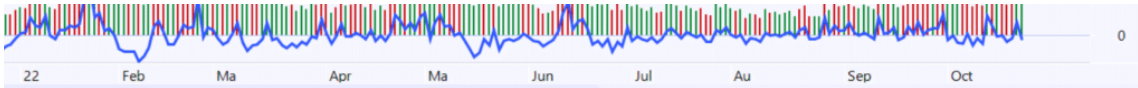
The SPY D1 chart will give us the context and it will tell us when to expect trend days and when to expect low probability days. It will also tell us when to swing trade. Think like a NASCAR driver. Decelerate into the turns and hit the gas on the straight aways. You should not have the "pedal to the metal" during the entire race and there will be pit stops (cash). I've described much of this price action in the article on hedging so you can reference it there. The chart below will give you a visual in an up trend.



Know that the cycles will not always be equally spaced like they are in the chart above. Conditions were stable for years and the macro backdrop did not change much. That resulted in the nice orderly trend.

2022 Market

In 2022, the macro backdrop changed and the Fed started to raise interest rates. After an 18-month bull market that rallied 100% off of the low, we had to wait for technical confirmation that the up trend was going to reverse. That meant keeping swing trades to a bare minimum. If we did get the trend reversal, we were going to have some great opportunities to make money on the short side. In the chart below, the blue boxes show you where we could have been more active swing trading. Some of the cycles lasted longer than others. That is the nature of bear markets. You will also notice that the bounces were violent. We did have a series of lower highs so it was important to wait patiently for resistance at the major SMAs and for a technical breakdown. The intraday ranges were very wide so there were excellent day trading opportunities. From a swing trading perspective, we were in and then sidelined. There were extended periods where we had to be passive with swing trades. That was not a problem because the intraday ranges were wide and there were plenty of day trading opportunities.



2023 Market

In 2023, there were signs that the bear market was over and we had a nice up trend during the summer that was getting tired. We had a giant bearish engulfing candle off of a relative high. We had to wait patiently for confirmation of a reversal so that was a “pit stop” for swing traders. That is when you keep your swing trading to a minimum because there will be big overnight moves in both directions and we do not have a clear sense of market direction. There will be good day trading opportunities. Buyers and sellers are battling it out and there wide intraday ranges. You can see that by the size of the green and red D1 candles in the middle of the chart below. As the move unfolded, we learned that there were only a few swing trading windows during this drop. The bounces were too violent. That was a sign that buyers were still interested and that this was a weak trend lower. You had to short failed bounces and you had to take gains into deep drops. This price action provided us with very important clues. The market had found its footing after a bear market in 2022 and this pullback was not strong. When the market found support, we were going to get a big rally.

The market was in the process of reversing a short-term down trend and it was going to rejoin the long-term up trend. In the early stages of this process, the cycles will last longer. This is when you want to take longer-term swing trades and when you want to aggressively day trade from the long side. We can also expect some “Gap and Go” moves higher and we can join them early in the day. This move is going to gain traction and we are going to move higher with vigor. You might only get this set-up every few years so be aggressive. Here is a post I made on Reddit just before the move. [This Post Will Make You A Lot of Money!]

As of this writing, you can see how the upward momentum is starting to wane in the chart below. The candle bodies are fairly small indicating that the intraday ranges are tight. This is a time to be more passive. Take gains on longer term swing trades and wait for the next opportunity to set up. We just gorged ourselves for 4 months and those gains are going to feed us for a few months. Day traders have to watch for bullish trend days. When the intraday action is light (most days), you have to find stocks with heavy volume breakouts and they need to have nice orderly price action. Keep your trades small. If you can't find these stocks, set alerts. Do not force trades!

The market has ebbs and flows. It doesn't move in a linear fashion so you need to adjust your trading to fit the conditions. There will be times when you rely more on day trading. When the market is transitioning from one trend to another, buyers and sellers will be battling it out and there will be big intraday ranges for day traders to feast on. Once a trend reversal is confirmed, those early cycles tend to last a few weeks or more. In time, those cycles will not be as dramatic and they won't last as long. There will be retracements and you need to time those cycles for your swing trades.

If you strip out all of the days I mentioned earlier in this article, we don't have a market tailwind for most of them. That means that day traders have to remain cautious and they need to wait for trend days. If the intraday ranges start to expand and if we see mixed D1 candles, it is a sign that a big move is coming. Buyers and sellers are battling and one side or the other will prevail. This is great for day trading, but we hold off on swing trading. It could be a trend reversal, but we need technical confirmation before we can swing trade in that direction. Bear market cycles tend to be more violent. The drops and the bounces are bigger. Wait for failed bounces and short weak stocks. Take gains into deep troughs knowing that the bounces will be violent. Bull market cycles tend to be fairly brief and shallow. The entire trend is more orderly. It is common to have tough trading conditions in a bull market. You have patiently wait for those dips and when you get them you have to strike quickly and with confidence. They won't last long. When you get the next leg higher, look for signs of exhaustion and take your gains. The context from the D1 chart of the SPY and the stock will provide you with valuable clues on how to trade each cycle.

Chapter 18: Get Your "House" In Order

If your life is filled with stress, trading well will be extremely difficult. You need to address the source of that stress and remove it or wait for it to pass.

This is going to be a relatively short article, but it is an important one. When our mind is preoccupied with other things in our life, we are not fully focused on trading. This profession is filled with ups and downs and we can deal with them when we are on top of our game. When your life is "upside down," you will be an emotional train wreck and you will make poor decisions. At a moment's notice, your trading day could be disrupted. You won't be able to manage your positions and when they are on "auto pilot," your risk of a bad outcome is high.

Health

If your physical health is poor, take care of yourself. Get the treatment or the therapy you need and give yourself time to heal. The same is true for your mental health. Trying to trade when you are not "right" yourself time to heal. The same is true for your mental health. Trying to trade when you are not "right" mentally is like throwing gasoline on a fire. If you struggle with dependency issues, address those immediately. You need to have a "clear" mind to trade and awareness is one of the keys to success. You will not be alert and you will make bad decisions. This is why casinos offer free cocktails when you are gambling. "Sound body, sound mind." To trade successfully, you need to be at your best. The market will always be there for you. Get yourself well.

Primary Caregivers

If a family member is ill, spend time with them and help them get better. If you are the primary caregiver, your attention will be divided. You will be physically and mentally exhausted and you will be prone to making bad decisions. "I don't have a lot of time to trade today so I need to find some good picks in less than an hour and hope for the best." You do not want to force trades when you are in this mode. You will become frustrated by your role as a primary care giver because it is robbing you from your normal activities. Your trades will suffer and it will impact your relationship with the loved one you are taking care of.

Day Job

If your job keeps you busy during the day, focus on long-term swing trades. Don't try to day trade between meetings. You won't trade well and you will not perform your job well. If you hate your boss and your job, trading while you are at work is not the solution. Find a new job where you can work when the market is closed or change to another shift. If trading is your passion, you will be able to focus on it during the day. Changing jobs is a big "ask," but it's what you have to do if trading is your passion.

Debt

If you are deeply in debt, you are not going to trade your way out of it. "Scared money never wins" and you will find yourself in an even deeper hole. You will not have any staying power and you will be a nervous wreck. You need this money and you can't afford to lose a dime of it.

Rocky Relationships

If you are married and your relationship is "on the rocks," it is going to add incredible stress to your life. Your relationship is probably the only thing you are thinking about. You will be trying to trade, but your mind will be elsewhere. Let these "seas" calm before you resume trading.

Suboptimal Conditions

Home remodeling, natural disasters and moving to a new residence are all stressful periods in our lives. Your "trading cave" has been uprooted. This is where you get into "the zone." Your lights, your monitors, and your layouts are perfect. In any other environment, you will be like a fish out of water. In time, you will be back in your space and then you can resume trading.

The Market Will Always Be There

I've either dealt with these issues personally or I've talked to traders who have been affected by them. You will not be at your best and you need to be. The margin for error in trading is slim and waiting for these clouds to part is important. I've made poor trading decisions when my personal life was filled with stress and they were very costly. I learned to stop trading during these periods the hard way. Get your "house" in order and now that the market will still be there when you are ready.

Chapter 19: Trading Is A Business

Businesses are very easy to start and they are difficult to grow. There are a million ways to fail and only a few paths to success.

Introduction

Many novices view trading as an easy way to get rich quick. Most of them lose their money and they are done with the "experiment." The experience was painful and they'll never return. A small percentage of these traders enjoyed the process even through they lost money. They realize that this is going to take a lot of effort and they are ready to take it seriously. They roll up their sleeves and they follow our suggestion to trade one share of stock and to focus on their win rate. Having a steady source of income during this stage is very important. Focus on your "real job" and don't get distracted by trading. You will need that steady income because you will not make any money trading for a long time (and you shouldn't try to). Besides, trading might not be right for you. In the future, you will know if trading professionally is viable. The first sign that it might be right for you is that you eat, breathe and sleep charts. It's all you can think about and you never miss an opportunity to learn. Your first goal is to get your win rate consistently above 75%. This will take a couple of years and once you get there you starting to scale up from 1 share. From this point forward, you need to treat trading like a business and your goal is to never hang the "out of business" sign.

Starting Your Business

There is no reason to go overboard with expenses initially. Just like our suggestion to trade small when you start, keep your expenses small. Make sure that this is something you enjoy and something that you can see yourself doing for the rest of your life. You don't have to be a professional day trader, you could be an active swing trader. Managing a basket of swing trades is also a full-time job. Most pros adjust their trade duration based on market conditions so plan on doing both. In time, you will decide if you should end your trading journey or to commit to it. For those that continue, you have realistic expectations of how hard this is going to be. This is no longer a “game,” it is a business. Here are some things you should do along the way and some insights on what it’s like to be a professional trader.

Learning

The first thing you need to determine is how and when you are going to learn. This is important from the very start. Videos, podcasts, social forums and books are great resources. Find a time and a place when you can concentrate on the lessons. Simply getting through the material is not enough. You have to study it and apply it to your trading. It’s important to take notes on the points that really hit home. If your surroundings are filled with distractions, you are likely to miss the important concepts. If your goal is to sample the content to determine if it’s worth your time, it’s fine if there is a little commotion around you. If the content is good, plan to go back and study it when you are in a nice quiet place. It’s critical to think about how you are going to apply these concepts when you are trading.

Office Space

You also need a quiet, comfortable place to trade. Find a room that you can call your own. When the door is closed, “we don’t bother daddy (or mommy).” Remove any distractions and make this space your “trading cave.” Everyone needs to respect that you are working so make this clear. Your family members need to understand that this is not where you go to relax, this is where you work. You don’t have to spend a ton of money on your “cave” initially, but as you get more serious about trading, you should make it comfortable. Make sure the lighting is good. You don’t need an expensive computer. Most trading applications are fairly “light.” As you get more serious about trading, a $600 – $1000 computer will have plenty of power and for another $500, you can add a couple of 32″ curved monitors. It’s important that you have a broadband internet connection and cable is the most reliable. I suggest NOT using a WIFI router. An ethernet connection is best. Your “cave” is where you will write your daily trade logs and it could be where you do most of your studying. That’s why it’s important to create the right environment.

The point to these prior two paragraphs is that you need to think about this seriously. Trading is not something that you can take casually. The margin for error is paper thin. This is not something you can study when you are driving, between business meetings or when it’s your turn to take care of the kids. Since you still have a full-time job at this stage, you will need to monitor trades and alerts during the day on your mobile phone, but you should be doing all of your research the night before or early in the morning in your your “cave.” People who try to make trading decisions from start to finish on a mobile app during a commute will not make good decisions.

Where To Put Your Money

Choosing the right broker is also something that you should determine early on. Commissions will add up quickly and this cost should be your primary consideration when you choose one. I am not overly concerned with payment for order flow. I tend to use limit orders and I have not noticed a big difference in the stock fills between direct order routing and using a broker that receives payment for order flow. Where I have noticed a difference is when I am able to preference an options exchange. An option order that does not fill on one exchange will often fill on another. If I can't get a fill on one exchange I will cancel the order and I will try another. Of course, you will pay extra to be able to preference the exchange, but if you can improve your fill by a nickel (or more) it will more than offset the additional cost. For futures there is always one primary exchange where the orders are routed so the commission per contract is what matters. Most brokers have excellent software (trading platforms) with a wide variety of technical tools. It's really important to learn all of their offerings. That's the only way you can make a true comparison. Know if they have any proprietary tools (searches, technical studies, hot keys, options analytics and order entry features). The user interface and the display are also important. Some firms offer research (earnings release dates, analyst ratings and news feeds). Here are some other considerations. What markets do they offer access to (stocks, options, forex, crypto, futures, foreign stocks, bonds and after hours markets). How "deep" is their "available to borrow" list. This will be important for those of you who short stocks. What is the margin interest rate they charge? Are there any extra fees for real-time data? Are there any account maintenance fees? How do they handle exercise and assignment for options? What margin requirements do they enforce for naked options and credit spreads (it should be the exchange minimum margin requirement)? How will you be notified of early assignments? What level of option trading will they approve for your account? How will you be notified if there is a pattern day trading (PDT) violation? How easy is it to reach support? I would test support out before you move all of your money over to a broker. When you need them the most, you need to know they will be there for you. Do they offer education? I believe that you will get an honest overview of the different brokerage firms from most trading forums.

As you become more serious about trading, you should invest in a really nice chair. You are going to be sitting for 10 or more hours a day. There are so many ergonomic chairs to choose from. Some people have kneeling chairs while others prefer to have a desk that allows them to sit or stand. What ever your preference, this is something to consider. You need to be comfortable.

We have not gone "overboard" with expenses, but it's time to determine if trading is something you want to pursue long-term. You don't need to make any hasty decisions. Keep your primary source of income as long as you can and only "go pro" when you are confident that you will be able to make the income you need and when your personal life allows for it. By this time you should be a consistently profitable trader and you should be ramping up your size. Trading becomes more difficult when it is your sole source of income. Some traders believe that it will become easier because they can focus entirely on trading. In reality, it becomes harder because there is no safety net (secondary income) and you've closed those doors. There will be fluctuations in income. Some of it will be performance related and some of it will be market related. In my Think In Terms of Cycles article, I discuss market cycles.

These next items need to pay for themselves. If they don't, get rid of them. I am talking about research, news feeds, searches, chat rooms and trading systems. These monthly expenses can add up quickly. Option Stalker Pro is a software program I developed and it is fairly expensive. It was designed to trade this system. If the searches, proprietary indicators, trade signals, alerts and automated trendlines don't help you find, enter and searches, proprietary indicators, trade signals, alerts and automated trendlines don't help you find, enter and exit trades, get rid of it. You need to track all of these expenses because you will write them off against your trading income.

Life Of A Professional Trader

Let's talk about what it's like to be a professional trader. You are isolated and you will be spending many hours a day alone. I spent my first 5 years without any outside contact and I missed interacting with people. I checked out a few chat rooms. Most of what I saw was a bunch of random ideas and junk that I had to sift through. I also didn't know which (if any) of the traders were good and I didn't know the basis for their trading decisions. This is shameless self-promotion, but I created a chat room that addressed these short comings. Our community only trades this system and the trades have to conform to it. Members are expected to study the system. If they post trades that don't "fit," they will be deleted and the member will be warned. This has not been a big problem because everyone wants to stick to the system. Now we can all look at a chart and know exactly why the posted trade made sense. It is laser focused during market hours and there is no small talk. Entries need to be posted on a timely basis and if you post an exit, there had better be an entry to go along with it. I don't want to hear about someone's 1000% winner if an entry was not posted. I also built a community where we help each other to become better traders and I reward traders for doing so. I think it is important to belong to a community of traders. You will help each other find trades. Some communities are free and some cost money. I do charge for mine.

This is a very sedentary job and your long-term health is one of the occupational risks. Your lower vertebrae degenerate faster because you are sitting all day and you can develop back problems. Doctors claim that sitting is the new smoking. You need to schedule time away from your screen. Even if it is 5 minutes per hour, it will keep you from straining your eyes. Make sure that you look away from your screens every few minutes and try not to fixate on them. After doing this for 30+ years, my eye sight is compromised. Some of that is age related and some of it comes from staring at a computer all day. Make sure that you take time to exercise. It is a great way to relieve stress and your body will need that movement after sitting all day. Even though I exercise, it's hard to keep the weight off when you sit all day. If you struggle mentally, you will be isolated and the stress of trading can really take a toll on you.

Weekly Routine

My typical week starts Sunday afternoon. That is when I review the previous week's logs, I look at my trades and I devise my game plan for the week ahead. I also record a YouTube video. I look to see how international markets are opening. I look for attractive trades and I set alerts on those stocks. I also set alerts on my positions above and below the current price. The alerts help me keep an eye on the positions because I am often distracted during the day running OneOption. The rest of the week is pretty typical. I start at 5:30 AM (3 hours before the open). I read the overnight headlines and I am looking at stocks that are moving pre-open. I am watching the futures trade and if there is an economic release before the open I want to gauge the reaction. I start writing my game plan for the day and it spans the next few days and sometimes a bit longer. Those are my pre-open market comments and I post them in the chat room. I know what the market is likely to do and the scenarios that would present the best trading opportunities. Once the market opens I spend the day searching for stocks, monitoring the market and setting alerts. My early activity is focused on taking gains on short-term swing trades. This is especially true if I get a nice move in the stock and if I am not expecting a big market move that day. For day trading I don't trade the first 45 minutes very often. When opportunity arises I am entering trades and managing the exits. I am more inclined to take swing trades in the middle of the day once I am able to observe the price action for a few hours. After the close, I answer questions for about 30 minutes. I don't eat during the day so I take a half an hour to eat dinner. This is pretty important. You should have your meals planned out ahead of time and when possible, prepared ahead of time. Make healthy choices. Remember that you are sitting all day so you need to do everything you can to stay healthy. You will be doing this for the rest of your life and your day-to-day decisions are cumulative. When you find your window of opportunity to eat, you need to be able to heat it up and return to trading. You can eat it at your desk. When you don't plan your meals ahead of time, you will be hungry and you will grab junk food that is close at hand. There was a period of time where I did not plan my meals ahead of time. I would ransack the kitchen like a Tasmanian Devil. I was hungry and I needed something quick because I had "positions on!" You will gain weight quickly and you will feel like garbage if you don't prepare your meals ahead of time. I like to eat after the close because I can relax. Intermittent fasting keeps me alert during the day and I don't have energy "spikes and valleys." After I eat, I go for a 90 minute walk outside. I never miss a walk and it doesn't matter if it is 30 degrees below zero with a foot of snow. It clears my head. I tell myself that if I would go fishing in this weather, I can walk in it. I ice fish so that means I walk every day. Walking is actually new in the last 5 years. Previously, I would lift free weights and do cardio (Stair Master) for 90 minutes on alternating days. I would hit the gym six days a week at 5:00 AM. It made me feel alert, awake and energized. When I was in this routine, I did have to eat during market hours. I highly recommend exercise. I can't walk in the morning because it is pitch black so I have to get my exercise later in the day. When I get back from my walk, I review my trades, I look at what's moving after hours and I write my log. I am also looking for new trades. This takes two to three hours. Then I watch a game or mindless TV for an hour while I plan/prepare my meal for the next day. Friday's I turn the lights off after the market closes. I eat and I go for a walk, but I stay out of my "cave." This is just the trading part of my life. Building Option Stalker Pro and writing The System happens separate from all of that and I fit it in where I can. It is a busy life, but I go to bed tired and I sleep well.

I said this earlier and it is worth repeating. Starting a business is easy. Growing it is hard. Risk management is very important early on. In your first few years, you don't want to take over-sized positions. You won't always know the right set-ups and you are still learning. The key is to never hang the "out of business" sign. You can't afford to take a devastating loss at this juncture. If you do, it is likely to be your last. When you had your primary income, you were able to shoulder more risk because you were getting paid from your full-time employer. You had the ability to earn back those losses. Now you don't have that cushion. In time, your capital base will grow and you will have more experience. You will be better able to identify high probability opportunities where you can "size up." You scale in and you add on technical confirmation. Your average cost will be lower than the current price and you can always scratch the position if it sours. It won't happen often, but it is very important to be able to handle this mentally and this approach helps me. This is "next level" trading and you don't need to worry about it for years. We all know when the market is not giving us much to look at. We also know when the backdrop is excellent. We don't get many of these "runs" during the year, but we should expect a few of them and when they happen, you need to be aggressive. Early on you will be pressing hard and trying to squeeze everything you can out of your capital. As your base grows, you will not have to push as hard because a smaller percentage return on your capital will still generate the same income because your base is bigger. Trading will become much less stressful when you reach this point.

Taxes

You've decided to "go pro." One of the first things you should do is to set up an LLC and to gain status as a professional trader for tax purposes. There are many advantages so make sure to do this. How you write down losses, wash sale rules and the Medicare tax calculations based on your trading income are just a few examples of where you will benefit. You should set up a 401K for your LLC and fund it with your trading profits. Your LLC will have a matching contribution and the annual amount of money you can put into the 401K is substantial. Max out your contributions each year and you will have a nice base to work with in just a few years. That account will eventually become one of your primary trading accounts. Unlike your other account, money goes into the 401K, but it doesn't come out. It will grow quickly. Make sure that you set it up so that you can trade everything (stocks, futures, all options strategies, currency, crypto, bonds, real-estate….). All of your trading profits in this account will be tax deferred. I am not a licensed accountant, so this is all I have to say on the matter. You are a professional trader now so seek professional tax advice for your business. It should go without saying that you need to track all of your business expenses. There will be some home office write downs as well.

You will need to calculate your P&L. There are many software programs that will download all of your trades and calculate the profit and loss. You will need to do this during the year and you will need to make estimated tax payments after each quarter. I take time off at the end of the year and I wind my trading down. The market is typically very dull. I like closing all of my positions before year end. Then, I start fresh at the beginning of the new year. My ending balance December 31st less my beginning balance January 1st tells me exactly how much I made that year. Every commission dollar, every exchange fee, SEC fee, assignment fee, debit interest expense and maintenance fee is accounted for in that number. This is not necessary, but it is what I have done since I started. I have found that the price action from December 26 – January 1 does not move much so I am not missing anything by not holding positions over that period. What happened the previous year (good or bad) happened in the previous year. Those books are closed and it is time to start the new year. Working from a "clean slate" makes me focus hard in January. I want to make good decisions and I want to start the year off on a good note. I am not encumbered by any "losing trades" that were carried over from the prior year.

Time Off

Speaking of time off in December, you will have to schedule time off for vacations. Early in your trading career, you will not want to take time off for fear that you will miss a big move. You are counting on that income so you feel like you have to work every day that the market is open. I like to add a day before or after a major holiday. Typically, the market does not move much on either of those two days. If there are major economic releases on one of those days, pick the day that does not have a major release. These 4-day weekends will give you a nice break during the year and you will not miss much. Try NOT to be away during the FOMC statements. There are eight of them a year. The March, June, September and December meetings also coincide with triple witching (third Friday of those months when options and futures expire) so make sure to stick around for those. This adds to the volatility so you do not want to miss these weeks. The middle of August through Labor Day is another great time to take a vacation. The Fed is in recess along with Congress. Q2 earnings season has ended and the economic releases are light. The weather is great and the kids are getting ready to go back to school. Many traders take time off in August so the market is typically slow. Take the last trading week of the year between Christmas and New Years off. The kids are not in school and it is "family time." Enjoy the holiday and recharge your battery.

Paying Yourself

It's important to pay yourself. Take money out of your trading account each month and put it in your checking account so that you can pay your bills. The difficult thing about trading is that your income will not always be steady. Some of it will depend on how well you traded and some of it will depend on market conditions. You can address performance, but you can't change tough market conditions. When you have a really good month, take some extra out of your trading account. This accomplishes two things. First of all, you will not feel as much pressure during months when the market doesn't give you much to work with. Don't trade for the sake of trading. When conditions are tough, you have to lay low. The second benefit of taking money out of your account is that you won't be tempted to "ramp up." Your confidence is high and the market moves in cycles. There's a good chance that you rode a trend and that it is likely to stall out. Early in my career, I would pretend that I just took a loss. That grounds me mentally and then I am cautiously trying to recover from it. My trade selections are better and I am less likely to get "sloppy." When I have a big "run" a few times a year, I take a nice chunk of money out of the account. Again, I have less money to work with & so I am more cautious. I use that money to pay taxes. These are just some methods I use to smooth out the "bumps in the road."

Carefully track your expenses. Home office expenses, education, internet, chat rooms, news feeds, trading software and much more can be deducted from your income. If you use it for your trading, there's a good chance you can deduct it. Just make sure to keep track of it and give those receipts to your accountant.

Health Insurance has become a major consideration. When I started as a "pro" over twenty years ago, it wasn't cheap for a family of five, but it wasn't outrageous like it is now. Ideally, you have health insurance through your spouse's employer. Early on in your trading career, you need that security and your spouse's job security is very important. COBRA can be expensive if they lose their job. If your spouse does not have health insurance and you have kids, the decision to "go pro" is much harder. My wife and I are over 60 and we are in good health. We are not eligible for Medicare yet. The best route for us to take is to have a very high deductible ($18,000 combined maximum out of pocket). This is catastrophic health insurance. If anything happens to either of us, we will hit the $9,000 individual "out-of-pocket" maximum right away. If something happens to both, of us we will hit the $18,000 maximum easily. Medical expenses are sky high these days so it doesn't even have to be a major health complication. Our monthly premiums are $2000 and the copays are high. We could conceivably pay over $42,000 in health insurance a year if we are ill. If nothing goes wrong, we will still pay at least $24,000. This has become a major consideration for professional traders and chances are you will be buying your insurance through one of the state exchanges. If you are an insurance agent and you have a less expensive plan, don't contact me. Write an article and post it in a Reddit sub where traders can see it.

It is always wise to have a second income. That could mean that you keep your salaried position for longer or that your spouse has a steady job with a reliable income. This takes so much pressure off of you. It is always wise to have a contingency plan before you "go pro." If trading does not work out for you, can you get your old job back? If not, is your skill set in high demand? How secure is your spouse's employment? How easy will it be for them to replace their income and to find another job? You also need to define a timeline and a maximum drawdown that is acceptable to you and your spouse. You need to discuss this with each other. Know when you are on track and when you are not. Be open about this and communicate often. A trading career is uncertain and it will create stress in your relationship.

How Much Money do I Need?

I saved one of the most common questions for last. How much money do I need before I can "go pro?" That varies from person-to-person based on your life. All of the things I've mentioned play a role. How viable is this? How long have you been trading? How many consecutive months have you hit a 75% win rate? Have you been scaling up with real money? Have you ever traded in a bear market? Ideally, you are making a profit. If your trade size is still small, don't rush the decision to "go pro." Know that once you commit, it is probably your last and only shot at this career. If you are producing consistent results for a half a year and you have $100,000 in trading capital and enough money saved to cover your monthly expenses for a year, you probably have the minimum you need to "go pro."

What if I have enough money to cover my monthly expenses for a year and I trade with a "Prop Firm" that provides the capital? I honestly don't know the answer to this question. Typically, you will have to put up some money and the first losses will be your capital. These firms have strict rules and they manage risk tightly. They might force you to liquidate positions that have gone against you and the position might have ultimately gone your way. Most "Prop Firms" will "teach you how to trade." I don't know how good they are at doing so. Prop Firms don't have a vested interest in your long-term success. The longer you trade with them the more commissions they generate off of your account. They impose tight trading restrictions to make sure you don't blow out too quickly (they want you in that seat as long as possible) and they want to make sure that you don't lose more than your capital because then it bites into their capital. I can't say if this is a good path. One thing is for sure. You had better have excellent trading skills before you to this route. I suspect that they will take many "green" traders that are not ready. If you have gone the "Prop Firm" route, let me know how it went. I would love to hear about your experience good or bad.

Conclusion: Trading is a Business, Take it Seriously

Life as a professional trader is complicated. It is not easy and that is why there aren't many of us. The first requirement is passion. If this is something that you can't stop thinking about, you are more likely put in the hard work that is required. That passion needs to span years, not months. You need to be self-motivated to find answers. Asking questions is easy and most people won't dig to find what they need. Sometimes there is no answer and you have to conduct research. No one is going to tell you where to look, you have to develop those resources yourself. You have to be creative and explore new ways to trade. Your successes and failures need to be well-documented and you need to learn from those experiences. There is no finish line, you have to continue to read and learn. Being a professional trader is not just about "being your own boss." It's not glamourous and sometimes you are "lunch box Joe" grinding out a living. There is risk and uncertainty around every corner and during your journey you will do a lot of soul searching. This profession can place a lot of strain on your personal relationships. The earnings are inconsistent and you have to pay for your own health insurance. You sit all day so you are likely to use your health insurance if you don't take care of yourself. If this profession doesn't work out, there are no transferable job skills. There is time to "test the water" before you commit to this profession. If you are consistently profitable and you love trading, hold on to your secondary income as long as you can. Ease into this profession and treat it seriously. This is your one and only shot, so make it count.

Chapter 20: Not Adjusting To Drawdowns

We need to reduce our trading activity when our performance declines.

We've discussed the concept of market cycles. There will be times when the best trade… is no trade. As much as we want to make money every day, the market is not always going to provide us with the high odds set-ups we need. Traders will often force bad trades and they will lose money. Novice traders who try to make money before they are ready will get the market or the stock wrong. They will lose money because they are making poor decisions. Professional traders will sometimes get caught on the wrong side of a move, but they recognize that quickly and they adjust immediately. There's new information and they know that whatever they lost, they will quickly make back based on this new information. No matter what the reason, we need to reduce our activity and we need to identify the source of the problem.

What's The Market Doing?

The trader who hits a really nice market trend will finally think that they have "figured it out." Now they just have to repeat this every day. They start extrapolating gains out into the future and they have visions of grandeur. Soon after, they start "leaking oil" and they give everything back. If you find yourself in this situation, stop trading. Something has changed and you are going to keep digging a deeper hole if you don't find the source of the problem. Chances are you are either not predicting the market well or you are not selecting good stocks. Conditions have changed and the market uptrend is not as strong.

You could be out of sync with the market. If it is in a choppy stair-step pattern higher, you are buying horizontal breakouts to a new relative high. Those moves don't have much more upside and you overstay your welcome. Just as the position starts to produce nice gains, it reverses and you are stuck with a loss. Your approach should be to buy dips once support is established and to add on confirmation. This would be a tactic to use when you have an upward sloping trading channel. That lower trendline is where you want to be buying. When the market rally breaks through horizontal resistance, you are waiting for signs that the move is stalling out and you are taking gains into strength. Use the upper trendline as a guide. You might also be forcing trades in a low probability environment. If the market has been trending nicely, you might not be picking the best stocks. They need to have strong trends, nice orderly price action, heavy volume, relative strength and technical breakouts. Don't chase the stock if it is too far away from the EMA 8. Use alerts to buy dips. These are only a few examples of what might be going wrong with your trades. The point is to stop trading. Go back and analyze every market day and every trade. Write extensive logs. This is where you will find your answers.

Take A Step Back

When you take a step back from trading, you will immediately take some of the pressure off of your performance. You aren't trading so you are not expecting to make money. Know that you will find the answer and that your trading will improve. You should watch as many trades go by as possible before you take one. That could mean that you don't trade for days. Some of those trades will be winners and some of those trades will be losers. You tell yourself that you only have one bullet and that your life depends on it finding its mark. Your trade logs will reveal solutions and you will start to regain your confidence without even placing a trade. You will settle down mentally. Eventually, you will see a trade where everything lines up. All of the checkboxes are marked and your confidence is sky high. You can't resist taking this trade. You've waited patiently, so you enter it. Low and behold, it is a winner.

Now you have to think about all of the reasons why that trade worked out and why your confidence was so high. Typically, you will find that you were muddling around in a sideways market and that you needed to be more patient. You needed to "right this ship" so you focused on the best of the best and you waited for the market and the stock to set up. Your odds of success were high and you knew it. Now, imagine removing all of the marginal trades you have taken and only focusing on trades like the one you just completed. You've been humbled and it is time to "get back on the horse." Work your way back gradually.

The novice trader who is not ready to trade piles right in. They take a beating and they instantly go into revenge trading mode. That's where they get into a mindset that they are going to make that money back and that they "figured this out." These traders will also average down. They were wrong on the market and/or the stock initially. Instead of admitting that, they stick with their original thesis. They keep adding to a losing position and they can't admit that they are wrong. The stock could be falling below every major support level, but they continue to add. Their average cost is higher than the current price so they are losing money. Every time they look at their account they are an emotional train wreck. Eventually, they can't stand looking at it and they take a huge loss. They don't pause, they just keep adding to the problem. Learning how to trade takes a lot of time. There are no short cuts and they have much to learn. Most of these traders will never trade again.

Do Pros Lose?

Pros are not immune to losses. They've gone through this process many times and they know where the problem resides even as it is unfolding. Typically, it is because their thesis was flawed or because they were blindsided by news that could not have been anticipated. It could be that the market is transitioning. Perhaps a trend reversal is looming. In these instances, they need to curb their trading and they need to focus on what has them in a funk. If the losses were due to new information, there will be more opportunities trading in the opposite direction. Their thesis will change and the money they lost will quickly be made back and then some.

Pros can get over-confident. My biggest losses have always followed my biggest gains and I figured out long ago that it was prudent to take money out of the account after a big run. The account is still bigger than it was before the run, but this reminds me to make good trading decisions and not to get sloppy. This prevents me from going into a losing streak because I am throttling back before I reach that point.

me from going into a losing streak because I am throttling back before I reach that point.

Curb Your Trading

Regardless of the reasons, you've gone through a drawdown. This is not a time to ramp up, this is a time to curb your trading. You need to find the source of the issue and you need to figure out how to correct it. Extensive analysis of each trade will reveal the issue and you need to write about it in your trade logs so that the lesson is not lost. Stop the bleeding and do not dig a deeper hole. When it is time to start back up, be as patient as ever. Let scores of trades go by and wait for that "can't miss" opportunity. Your next trade has to be a winner and your career depends on it. This is the mindset you need to adopt. When you exit that trade, it is likely to be a winner. Note everything that took place. This is the blue print for all of your future trades. All of the checkboxes have to be marked and you are only going to trade the best of the best.

Chapter 21: Give It A Little Breathing Room

Many traders will smother a good trade. You've marked all of the checkboxes, but you start having doubts.

You are in complete control just before you enter a trade. Once you are "in," you are at the mercy of the stock and the market. You have to trust your analysis. Do you have any reason not to trust your analysis? You might be a novice trader who is still learning. In that case, you should be trading 1 share so the losses are tiny. Take the trade and stop worrying about it. Learn everything you can from the trade. This is a necessary part of the process. If you are a seasoned trader and you are nervous, it is probably not a high odds trade. Perhaps the market is choppy. In those instances, you take a small "starter" position because the odds are lower. You have identified market support and the stock has relative strength. Give it a little room to breathe. You don't need to micro manage every tick. If you can't stop looking at it, set an alert above and below the current price so that you are notified, then move on.

This scene from "Tommy Boy" reminds me of what I see many traders do. The trade is your new "pet."

Define A Waiting Period

I am a stickler for good entries and I don't advocate being sloppy. Provided that you aren't, give it a chance to perform. You aren't chasing long candles and you aren't buying during a big drop. You've waited for your window to set-up. When you enter the trade, define a waiting period. The stock might not move right away and that's OK. It might even pullback initially. There's a reason why you entered right now and why you felt that this was the right time. As long as everything is in line with what you expected, stay the course. You have previous price action to lean on and that sets the tone. If your time has elapsed and you have not gotten have previous price action to lean on and that sets the tone. If your time has elapsed and you have not gotten the move you expected, then you can decide to exit.

Give Profitable Trades Some Space

When the trade starts to go your way, give it some breathing room. Are the dips normal in size? We know what “normal” is from the previous price action. Some stocks are choppier than others so identify the size of the dips you are comfortable with. Most stocks do not go straight up or straight down. They have dips along the way. Ideally, you bought one of those dips. You want very few retracements back into the previous bar and you want lots of green candles. In the chart below the stock is grinding higher. It has nice tight orderly price action and it is above all of the major MAs and AVWAPE. It also has relative strength. The trader has excellent gains and they are nervous. At the first sign of trouble (bearish engulfing candle), they hit the panic button and they exit.

Embrace The Red Candles

As long as everything else is intact, be aware of the bearish engulfing candle. It is a yellow flashing traffic light that tells you to proceed with caution. It does not mean "run for cover." Learn to embrace those red candles. What happens after that red candle often indicates how much more upside the stock has. The one above is not over-sized. If it represented a 5% move, obviously you would be on very high alert and you should be checking the news wires to see why the stock dropped like that. In this instance, the bearish engulfing candle is erased immediately. This is a sign that the stock is going higher. Instead of exiting the trade, you should be adding on this confirmation. If that bearish engulfing candle has follow-through to the downside, it is a sign that the stock is starting to lose its momentum. It has not dipped previously and that tells us the trend is very strong. We still do not need to bail on the stock. With price action this tight and orderly, it is at very least going to test the previous high. That knowledge gives us the confidence we need to stay the course. If the stock struggles to get through that previous high, we can start to take gains. If the stock powers through the previous high, we stick with the trade and we might even add. This was the first sign of selling so we watch for price compression or future red candles. Those would be a sign that the trend has run its course.

We are only picking stocks with very tight, orderly price action and strong trends. That is a sign that institutions are buying. If you are trading a choppy stock that is all over the board, those dips could gain traction and the stock could have a deep drop. Then your caution would be justified… but we aren't trading those stocks. There's no need to compromise and we can always find stocks that are in a strong trend.

Stay The Course

Give the trade some time to produce. If you were patient with your entry, let it move around a little. As long as the market and the stock are "behaving," stick with it. If your time has elapsed, exit the trade and set upside alerts so that you know when it is making a move. Once you are in the trade, remind yourself why it still looks good. If all of the checkboxes are still marked, don't mess with it. Embrace red candles. There will be profit taking along the way. As long as the dips are normal, prepare yourself mentally to weather them. Be confident in your ability to identify nice, tight, orderly trends and know that off of any dip the stock at minimum is going to get back to the prior high. The price action after the dip is going to tell you how much "gas" is left in the tank. An immediate surge to a new relative high is a sign that it still has more room to run and it might be time to add to the position.

Chapter 22: The Risks Of Over-Trading

Many traders take too many positions and this makes it harder to

Many traders take too many positions and this makes it harder to manage the trades. Cull out the marginal picks and focus on the best.

Asset Managers spread risk out over many uncorrelated assets for diversification. They take long-term positions that might last for years and they are not in and out of stocks. They adhere to the old investment adage, “Don’t put all of your eggs in one basket.” We are not investing and that advice doesn’t apply to short-term trading. In fact, it’s quite the opposite. We are riding the fastest horse and our goal is to find the “best of the best.” Short-term trading is like the Pony Express. When one horse tires, we jump on a fresh one. We control our risk by keeping our trade duration short. We are aware of scheduled events (like earnings) and we avoid them. If you read the notes from your trade logs, there will be certain trades that you felt much more confident in. Chances are they performed well. Think of how your P&L would have improved if you had eliminated all of the marginal trades.

Find The Best Of The Best

Early in your trading career, it will be difficult to find the “best of the best.” The opening bell rings and you are excited by all of the great trading opportunities. You have fasted and you just walked into an all-you-can-eat buffet. Everything looks good and you pile your plate as high as you can. You are spread out across many stocks and you might feel that you are reducing risk by diversifying. “Some of these will work out and some of them won’t.” The problem is that you are not carefully analyzing each pick, you are not being patient and you can’t properly manage all of these positions. This is a “shotgun” approach and you are not going to hit a 75% win rate. Your slippage is going to be higher (commissions and bid/ask spreads) and you are more exposed to adverse market moves. You are not ultra selective and your odds of becoming a “bag holder” (holding on to losing positions) increase. Let’s take a look at some of these issues in greater detail.

What I’m describing above doesn’t just apply to day trading, it is also true for swing trading. As a professional trader, I find that a maximum of 10 swing trades and 5 day trades at a time is manageable. I might swap out my holdings if a stock has lost its momentum, but this is a reasonable number of positions to hold. Realize that these numbers are not the norm, they are the extreme.

When To Be Aggressive

We have finite capital and our goal as traders is to be as efficient with it as possible. Throughout this course I’ve mentioned checkboxes. They start with the market D1. There are going to be rare instances where we need to act in an aggressive manner and they will typically surface around trend reversals. We need technical confirmation in the form of double tops or double bottoms and in the early stages of the trend reversal we should see strong sustained movement. We might only get a couple of these moments a year on a D1 basis and that is when we could hit the maximum number of positions. In the chart below, you can see our automated trendlines. The shaded areas are the “sweet spots” where we might carry the maximum number of positions. You will notice that the duration is brief on the short side relative to the long side.

When these "sweet spots" set-up, we are more aggressive with our swing trades and our day trades. In a down trend reversal where the market is starting to rally (right side of the chart above), we are looking for stocks that were steadily moving higher even before the market found support. Buyers have been accumulating these stocks so they have a full head of steam. This is where we want to focus our attention. Forget about buying stocks that are still forming a base. Buy the "best of the best" and forget the rest. As you can see in the SPY chart, these periods are fairly brief. The majority of the time we are not carrying as many positions and we are "swapping horses." We want to stay focused and we want to preserve our flexibility because the market tailwind is not howling and conditions are less certain.

Let's say that the market is in a D1 up trend (shaded area on the right side of the chart above) and there is a small gap down. This is our best day trading scenario! We wait for market support and we know that a gap reversal would provide us with a great entry point to join that longer-term up trend. We are not looking for stocks that gapped down, we are looking for stocks that are grinding higher and that are above the prior day high. There won't be many of them. Instead of considering 10 stocks to trade, there might only be 4-5 that are "bucking the trend."

Practice Being Selective

When you spread yourself out too thin, you are not forcing yourself to be selective. Each stock has its own patterns and some of them will be more attractive. It is critically important to identify these characteristics. When you are trading 1 share, write down why you picked XYZ and why you picked ABC. Write down why you believe that ABC will outperform XYZ in your trade logs. When the trades have concluded, write down what happened. Were you right? What was it that made the difference? This is how you refine your stock selection. Try to quantify those characteristics. Was it a D1 breakout? Did it have heavy volume? Was it the price action? Did it gap up? Was it strong relative to SPY? Was there news? Did the stock have any dips? How deep were they? Did the stock drop below VWAP? Was it above the prior day's high? The more detailed your description, the better. When you do your analysis at the end of the day, go through the searches and look for stocks that had the type of pattern you are looking for. Then start backwards engineering a scan in Custom Search that finds that symbol. Identify the variables that will help you find this pattern in the future.

In the scenario described above (M5 gap down in a D1 up trend), we have the set up we are looking for and we want to buy. The trader using the shot gun approach will buy a little of everything. His attention will be spread out across many different stocks. At times, some of them will perform well and then they will look terrible a few minutes later. This is a whirlwind of positions. The trader won't know where to focus their attention. In some instances they will "cut" the losers and "ride" the winners, but the winners turn to mush and the losers turn around. Sometimes the opposite is true and it was good to "cut" the losers and "ride" the winners. When you are looking at 20 stocks, it is much more difficult to get a feel for how they are trading. You only get this granularity by monitoring the stock very closely. In the first 30 minutes, you should let the market find its footing and you should search for attractive stocks. This is when you set alerts. If the stock is getting through key price points, they are worthy of a closer look. After an hour of trading, you are starting to zero in on the best prospects. Now you can watch them very closely. When the market dips, what did the stock do? Ideally, it didn't budge and it is on a steady grind higher.

"Dogs" & Getting The Market Wrong

The first problem with having too many positions on is that you included some "dogs." You were not as selective as you should have been. Those trades will require time and attention and you could have spent that energy monitoring the "best" stocks. When you have a basket of winners and losers, you are spinning your wheels. Even if you are making money, the losers are affecting you mentally. You can't help but wonder why you took those trades. What often happens is that you focus on taking profits on the stocks that are performing and you ignore the ones that aren't. You figure that they will "come around." At the end of the day, they never recover and now you are "bag holding" losers overnight.

The other problem with having too many positions on is that you might get the market direction wrong. If you get blindsided by a surprise move, there are too many stock positions and you can't unwind them fast enough. You could short S&P 500 futures as a hedge, but now you are complicating your trading. That is not the solution. Be selective and take fewer positions, that is the solution. Quality stocks will hold up very well because you have monitored them during a brief market dip or two. You can see that buyers are lined up. If you get the market wrong it will be much easier to reduce your risk.

Monitoring Your Stocks

When you have many positions, you aren't as able to identify strength in the stock because you are not hawking the M5 charts. Consequently, you don't know which positions to add to. When you have a few positions on you are keenly aware that the SPY just had a long red M5 bar and the stock had a nice green bar. You can closely monitor each stock and you will be aware of technical confirmation. You will have larger positions in fewer stocks.

When you whittle down to 4-5 really solid picks, your confidence will be much higher because you've vetted them carefully. There might be two or three that are performing well and that's all you need. If market conditions are poor, you might only have one or two stocks of interest. This would be the case during a low probability trading environment (LPTE) where the market is trapped inside of the prior day's range ("Inside Day"). Out of thousands of stocks, you can almost always find one or two gems no matter how bad the trading conditions are.

I've focused more on the day trading side than the swing trading side in this article, but the same concepts apply. If you are spread out across too many stocks, it will be harder for you to track your positions and to adjust.

Stock Diversification

Since you are taking fewer positions, avoid trading stocks from the same group. Also avoid stocks from the same sector if they are all highly correlated. For instance, if three of your five positions are from the energy sector, they are likely to be highly correlated. You don't want to be that highly concentrated. Pick the one you like the most. Technology companies can be vastly different from each other and having three technology stocks might not be an issue. Just make sure they are not three semiconductor companies (same group).

Shorter-term traders don't need to diversify across many stocks. The goal is to be in and out of stocks and to ride the momentum until it wanes. Each additional position you take complicates your trading because you have more to monitor. Instead, focus on the best of the best and be ready to add to those positions on technical confirmation. Also be prepared to take gains when the move is exhausted. Constantly search for better prospects and swap out of stocks that have not been performing. Swing trades require less monitoring and we make decisions based on major technical levels on a D1 chart. For that reason we can carry more of them (ten). Day trades require constant monitoring and you should not have more than five open at any time (max). This allows us to closely monitor the price action and we are better able to actively manage the positions. We can add to the position (or reduce it) based on price movement and market conditions. There might be slow days when we only have one or two day trading positions. It is important not to overtrade when the conditions are poor. On a slow day, one nice stock can produce really nice profits.

Chapter 23: Trend Reversals And Market Transitions

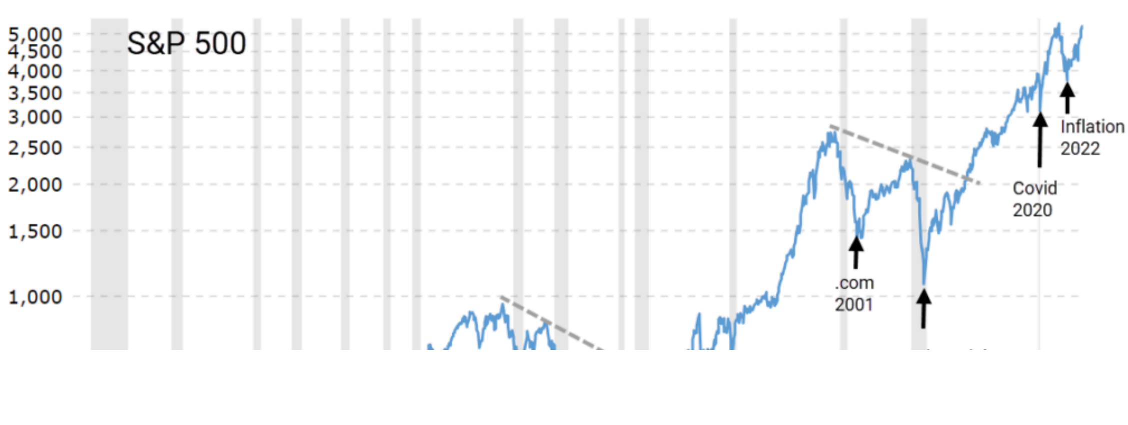
The market gives us signs that conditions are changing. Traders who are oblivious to these “tells” will be caught off guard and they will be humbled.

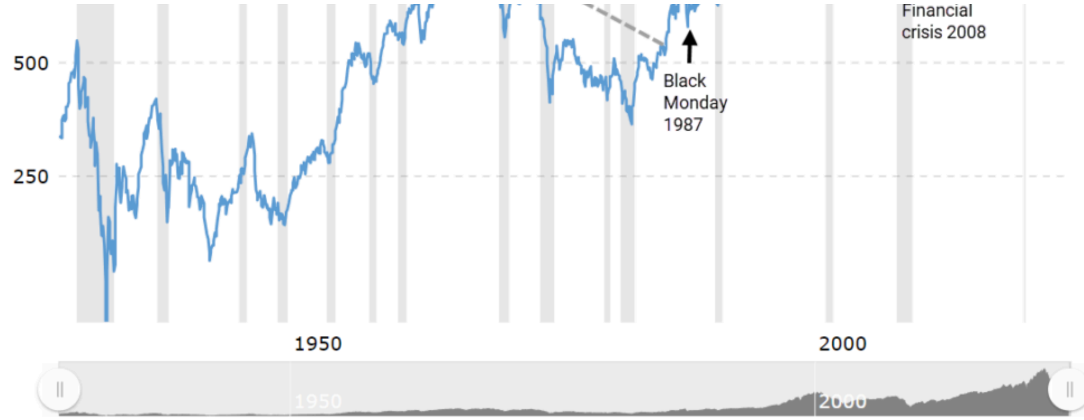
The market is always processing new information that might impact earnings, interest rates or economic growth. Buyers and sellers will adjust their forecasts and their risk exposure to stocks. It is important to know the macro forces that are currently driving the market, but you don’t have to become an economist. Read the market headlines and conduct basic fundamental analysis and you will know all that you need. We leave the heavy lifting for the institutions and when they are buying or selling, they leave a trail of bread crumbs. Price action tells us what they are doing.

Market First! Traders who are oblivious to this important concept will continue to trade just as they have been. They don’t adjust their risk or their strategies and they are blind-sided. They can’t figure out what changed, they just know that they are losing money. By the time they realize what’s happening, it’s too late. In this article, I am going to talk about a few different types of transitions and how you need to trade each of them. These are difficult periods to trade and they require some mental adjustment.

Identifying Transitions

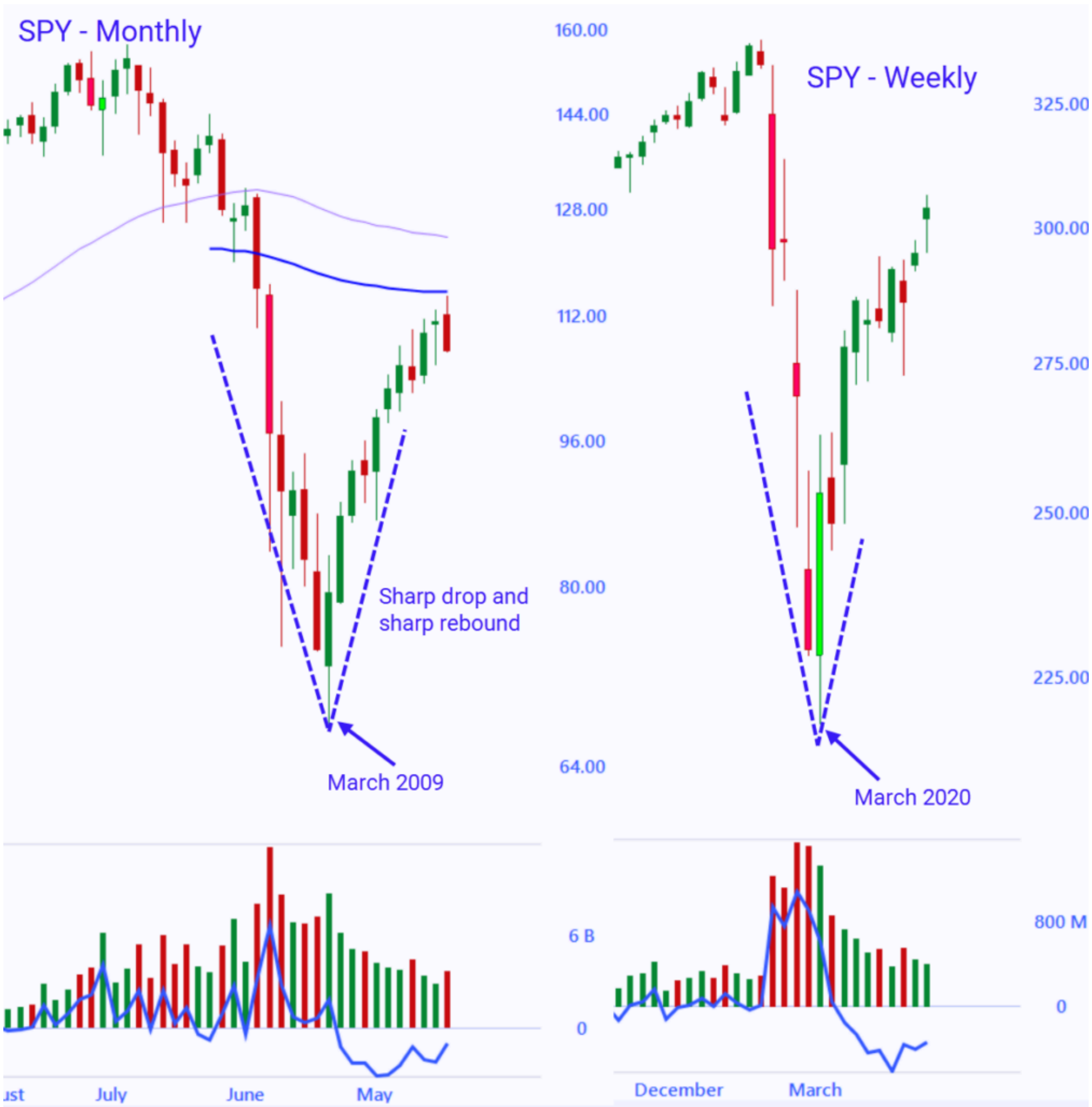
Let’s start with everyone’s favorite type of transition. We don’t often get trend reversals from a bear market to a bull market. They are powerful and they are emotionally uplifting. The reason why we don’t get many of these set-ups is apparent when you look at a 50-year chart of the S&P 500 below. Bear markets are not common. They last less than two years on average. Typically, people are laid off and the mood is very somber during a bear market. When conditions start to change, there is light at the end of the tunnel. When the bear market ends, there will be an incredible opportunity to “buy low” and to join that 50-year up trend. Asset Managers are aggressively buying and the trend during the initial stages of the rebound is very strong and predictable. As traders, this is when we need to be aggressive.





Types Of Bear Markets

There are two types of bear markets. One is credit related and it is surrounded by uncertainty. The financial crisis in 2008 and the Covid-19 crash of 2020 are two examples of events that sparked panic. In these instances, fear sets in and the selling is relentless. The smart money is "running for cover" and they wonder, "Could this be the big one?" Retail investors are in panic mode and the world seems like it is falling apart. The major media outlets "fan the flames." Bad news sells and they will "guide you through these stormy seas" – not. When I speak of uncertainty, I mean it in the most dire sense. "Will the entire financial system collapse?" "Will there be a run on the banks?" "How many people will die from Covid-19?" "Will this cause a financial collapse?" Credit is the common theme to big market drops and I wrote about it in the market fundamentals section. It is the one concern that can produce panic at every level – even institutions. That type of heavy selling pressure results in a very deep low. We call that a capitulation low and it forms a "V" bottom. This transition is fairly easy for traders to manage because you shift instantly from bearish to bullish. Long red D1 candles are erased by long green bullish engulfing candles. The low is in and it is time to buy. The journey to that low is gut wrenching. Remember, we are not bottom pickers! We need that capitulation low an it needs to be swift and very deep. This is NOT a market that is just drifting lower, the bottom has fallen out! There is blood in the streets! We don't see this set up often, but it is an over-reaction. We need those long green candles that blow through the open of the previous long red candle on the bounce. Then we know the low is in and then we can expect a "V" bottom recovery. This transition is fairly rare so I am not going to spend a lot of time on it. When you get these incredibly deep and fast market drops, the VIX/VXX will skyrocket. The world is falling apart! When you get that first bullish engulfing candle off of the low or that first bullish hammer with a very long tail, exit all of your bearish positions. If you are long put options, sell them. The option IVs will be extremely high and they are about to collapse. If you are an option trader, you want to be a put seller once the low is in. You want to sell those expensive IVs. You can sell naked puts, but your upside will be limited to the premium you collected. There will be longer-term plays and this will be a longer-term low. I suggest selling ATM bullish put spreads and buying OTM bullish call spreads with 3+ months until expiration. The height of the bounce will be very tall. You are selling expensive put options and you are buying expensive call options from an IV standpoint. If you are only buying longer-term options, you will only be buying expensive calls and you want to defray that cost. I will discuss this in greater detail in the options section. If you don't trade options, start buying stocks and plan to buy on margin. You want that exposure. As you know from my previous articles, never, never, never average down during the drop. It will be deeper than you could have ever expected and it will last longer than you could have ever imagined. This will mentally destroy you. You have to wait for that low (stacked red candles) and that super long green candle. Buy and add on confirmation (higher lows).



There are more common bear markets that have a gradual decline. There is not any “panic in the street.” In 2001, the issue was extreme valuations after the “.com bubble.” Valuations were too high. During the initial stages of the market decline, the move was swift. Valuations don’t cause panic, sooner or later, buyers will find these stocks to be “attractive.” We just have to wait for signs that support is forming. I started trading in 2002 and this was the most difficult market environment I’ve traded. Stocks were ticking lower and then a spike out of nowhere would destroy bearish swing positions. The US was preparing to invade Iraq and that added to the uncertainty. I didn’t know how to trade this environment and I was losing money. In April 2003, the US invaded Iraq, the market bounced and my trading turned around quickly. For those of you who were trading in 2022, you experienced difficult market conditions that were similar. This was a bottoming process filled with big drops and big bounces. The Federal Reserve launched its most aggressive tightening cycle ever and they hiked interest rates by 4% in a year to combat the highest inflation in decades. Institutions suspected that economic activity would implode, but it didn’t. The market move lower was very choppy and the odds that this tightening cycle could spark credit issues remained fairly low during that year. When the low was in, the rebound was very gradual. This was a more difficult transition to trade and I will explain why.

2022 Bear Market

In 2022 we were in a bear market, but the bounces during the entire year were very tall. You can see that in the weekly chart above (right side). That was a sign that buyers were still engaged. When the low was established in October 2022, the rebound was also very choppy. Unlike the "V" bottom formation I described, this was more of a bowl shaped pattern. You couldn't get aggressively long because the dips were deep. Mentally it was difficult to switch from focusing on the short side to focusing on the long side. We never had concrete evidence that economic conditions would not deteriorate after aggressive monetary tightening. Institutions kept expecting a recession and they kept pricing in a rate cut. Buyers and sellers were in a constant battle and over the course of a year, we learned that the US economy was strong enough to shoulder these rate hikes. As a trader in this environment, you were constantly looking over your shoulder and you were waiting for bad news that never comes. When the market is transitioning from bearish to bullish, the direction is uncertain. You can't get aggressive with your trades. Mentally you are shifting from… "focus on shorts" to… "longs and shorts" to… focus on "longs." Your trade duration is short-term and you are buying dips and exiting into strength. In the fall of 2023, the Federal Reserve stopped raising rates and that sparked a very steady market rally. The tight orderly price action you see at the far right of the chart below was a sign that a longer-term bullish trend was starting. Now we were finally in a "long only" environment where we could ride trades without the fear of a market drop.

According to Mark Twain, “If you have to eat a frog, it’s best to do it in the morning.” In other words, get it done quickly and don’t agonize over it. The same is true for market corrections. From a trading standpoint, the big fast drops are much easier to trade. The drops are deep and swift and the reversal is crisp and clean. As directional traders, we are active during strong trends and we have one on the way down and one on the way back up. When we have bear markets that meander lower, the trend is much weaker and so is the rebound. It is a bottoming process that eventually gains traction. The issues that lead to the bear market are gradually resolved over time. The steady rally that we had seen in the summer of 2023 told me that any drop would set up an incredible buying opportunity. In the middle of October, we were preparing for a fantastic buying opportunity and we got it. In the chart below, you can see the “V” bottom during the Covid-19 crash (left side) and the spike in option implied volatilities. [Selling Naked Puts In A Market Crash] is a video I posted in March of 2020 and you can see how we were trading. All of the other videos from that point forward focused on aggressively trading the long side. In the spring of 2023, I was much more cautious than I was in 2020. This bear market did not have much of a selling climax. We had a couple of large bank failures and right when I was starting to get bullish in March of 2023, I decided to stay guarded. Having been through a financial crisis, there was smoke and I wanted to see if there was a fire. By the end of the summer (2023), I was confident that these were isolated banking instances. The next pullback would set up an excellent buying opportunity.

Fall 23′

The transition in the fall of 2023 was not an easy one for most traders. We had just endured a bear market and then prolonged, low probability choppy conditions. When the time came to enter longs aggressively and to ride them, many traders did what they had been doing for the last year. When they had nice profits, they took them. Unfortunately, the market kept going higher and they would have to re-enter at a higher price. They failed to recognize that the back drop had changed. There were no dips so there was no reason to worry. When the market continued higher, they took gains when they were "satisfied." This is also not a legitimate trading approach. You take gains when the price action tells you to. Their tactic was more of a swing scalping approach. They made money, but not as much as they could have if they would have stayed the course and added to positions. It was very difficult mentally for them to shift gears because they had been "conditioned" to use a "hit and run" approach. The key was to recognize that the strength in the first half of 2023 would set up an excellent trading opportunity. Any dip was going to provide a fantastic entry for longer-term bullish swing trades and we would be able to ride them. The super tight price action in November and December and the lack of dips signaled strong trend strength and this was a move you could ride and add to. It's hard to "flip the switch" from neutral to extremely bullish. It takes years of experience and a high level of confidence in your analysis to do it. This skill is where traders take their game to the next level.

So now we have a nice strong bull market. We are on "easy street" – right? Trading is tough… always. We have to constantly adapt and adjust. There are stretches where profits come easily, but they are few and far between. Most of these "runs" come off of trend reversals. We have to wait for the early signs that a reversal might be forming and we have to wait for technical confirmation. In the early stages of that trend reversal, the price action is very strong. I will admit that the bear market of 2022 was very challenging. The price action on the way down was very choppy and it remained that way during the rebound. Traders had to exercise a great deal of patience. This was an incredible learning environment and only those with discipline survived. When the tide finally shifted in the fall of 2023, traders made a lot of money. Their first reaction was, “So this is what it’s like to trade a bull market. This is like shooting fish in a barrel.” I know this from comments in my chat room and from comments in Reddit and Discord. Traders made a lot of money and they were able to ride trades for a much longer period of time. Most of them didn’t make as much as they should have on the way up because they were scalping in and out, but they did very well. They had very high win rates for a few months and this was a big emotional lift for them after a couple of challenging years.

April 24′

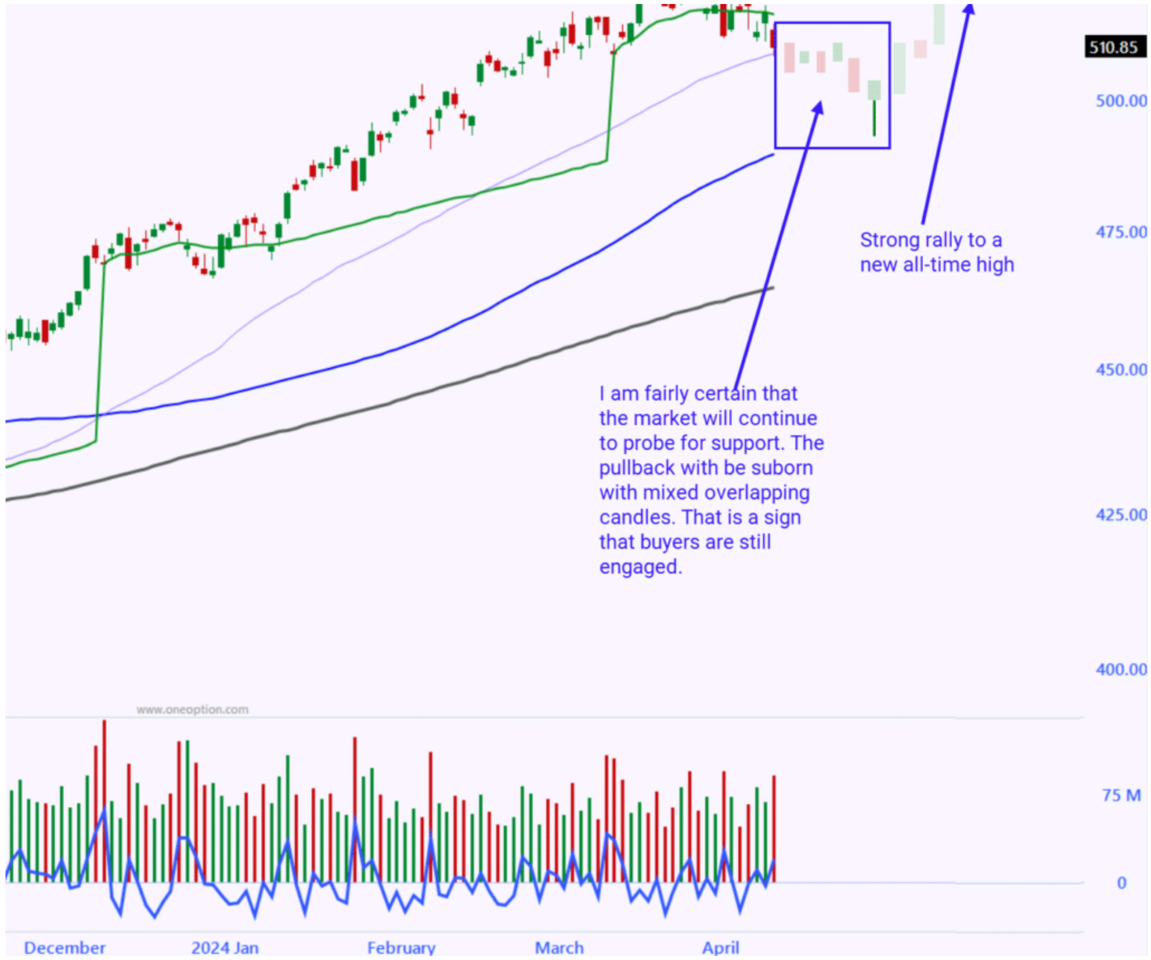
Trading bullish markets is generally less difficult, but it is not easy. As I write this lesson, the market rally is starting to mature. The upward momentum is starting to stall and the price action is “loose.” We are seeing more red candles and small gaps up and down. The price action is not nearly as tight and orderly as it was and this is the time to take profits on longer-term swings. Big market moves need time to digest gains and strong trends typically transition into horizontal trading ranges. The long red bearish engulfing candle in the chart below was a warning sign and traders needed to adopt a neutral bias. You will only see a long red candle that is 200% of the average true range on very heavy volume if sellers are aggressive. If buyers were aggressive, the market would never have dropped like that. The fact that there were no major dips and no long red candles told us that buyers were aggressive and that we needed to favor the long side to that point. Now we have new information in the form of price action.

Evaluate The Dip

As soon as the long red bearish engulfing candle surfaced (right side of chart above), we understood that intraday ranges would expand. How did we know that? First of all, the price action was starting to “loosen.” We no longer had a nice, tight, orderly march higher. The upward momentum had waned and we were seeing gaps up and down and more red candles. The market was trading in a horizontal range. Buyers and sellers were batting and that meant that both sides would be flexing their muscles. When one side was able to move the market, a nice intraday trend would result. When that move lost its momentum, we could expect that the other side was going to take their turn. This means that we focus more on day trading and a little less on swing trading. Given the recent trend strength, if the market did have a dip, it would be brief and shallow. Bull markets die hard and at very least, the market would bounce and it would make another effort at getting back to the high. This sets up well for selling out of the money bullish put spreads on strong stocks. This is a neutral to slightly bullish strategy. **Stock traders needed to wait for a dip and they needed to wait for technical confirmation of support before buying.** It is critically important that you understand the previous sentence. They should NOT simply expect that the market is going to breakout to a new all-time high. They needed more information to reach that conclusion and the dip would provide that. That long red candle off of the all-time high was massive and it is a sign of stiff resistance. A brief and shallow dip would be bullish and it would pave the way for a rally to the all-time high. They would hold positions if the market was able to blow through that horizontal resistance on the first attempt and if it approached that level with nice stacked green candles. Swing traders should take gains if the market shows resistance at the prior high, especially if it takes a long time for it to grind to that level and if the candles are mixed and overlapping (low quality bounce). We want to see a slingshot to a new all-time high. Anything less confirms resistance and selling pressure.

In the current environment, we are keeping our positions relatively small and the trade duration has been reduced. We are taking bullish and bearish positions on stocks that have relative strength and relative weakness respectively. Our market risk is reduced if we decide to take short-term overnight positions because we have a balance of longs and shorts. Our confidence on market direction is low at this juncture. We are clearly in a holding pattern and we are waiting for technical signs of a breakout one way or the other.

The long red engulfing candle tells me that there will be more selling pressure and to expect that dip. Buyers will be a bit more passive and this is the pullback they have been waiting for. The probe for support will be brief and shallow with mixed overlapping candles. Why? Because buyers will still be engaged. The 20% rally from November through February was not a fluke and that strong price action tells us that at very least, we will see one more move towards the all-time high. While I wait for this dip to unfold, I will keep my trade duration short-term and I keep my trades balanced. If I get this type of dip, it will tell me that buyers are still interested and that we should see an attempt to get through the all-time high. I am not guessing which outcome we will get. I am staying relatively neutral and I am waiting to see what happens.



If the dip lasts more than a couple of weeks and if it tests the 100-day MA (blue), it will be a sign that sellers are fairly aggressive. The dip was deeper and it lasted longer than bulls wanted to see. This is a warning sign that the selling pressure is building. The rally to this point was nice, but this would be a sign that the move is over-extended. If I see this pattern, it will tell me that a lower high double top is setting up and that would shift my bias to bearish. It would be a clear sign that resistance is building and the threat of a market breakout to a new all-time high is less likely than a pullback below the recent low. I would start taking starter bearish positions off of the lower high double top and I will add on technical confirmation in the form of a broken up trendline or a major SMA breach like the 100-day MA.

In summary, I will be watching this dip. If it is brief and shallow as I suspect, I will buy on the notion that we could challenge the high. I don't want this dip to last more than a week and I don't want it to go much lower. This is very important because it is a sign that buyers are still aggressive. I will hold bullish positions and I will expect that at very least, the market will test the all-time high. When we test the high, I want nice long green candles and heavy volume on the way up. I will hold longs, but I want to see an immediate breakout with follow through. I will be very cautious at the all-time high because we've seen resistance there. If the market can't breakout immediately, we could stay trapped in a range and I will start taking profits on my longs. The bid is still fairly strong and so is resistance. If we don't make a new all-time high a week after the bounce begins, I will take gains on my remaining longs. I will stay neutral (balanced) and I will reduce my trade size.

If the current dip lasts two weeks and if the SPY drops down to the 100-day MA, I will be less bullish. We will see a bounce, but I will not trade it as aggressively. I will be watching for signs of exhaustion and I will be looking for a lower high double top. Then my bias will shift to a more bearish tone.

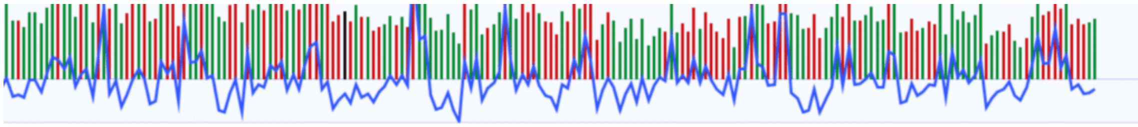
This is how traders adapt to changing market conditions. The previous price action tells us what to expect and we look for "tells" along the way. We are aware of the price action that would get us more bullish or more bearish and we are proactively looking for technical confirmation.

This is where my mind is currently and I will trade based on the outcomes above. It's important for me to describe the current set up because it is a real-time example of what is happening and how I am applying the lessons I'm teaching. The timeline for all of this is April 2024 and you will be able to go back and see how this all played out. I am not just describing what has happened, I am revealing my current analysis. These are the scenarios that will unfold. The patterns will tell me how to trade in the future. I will be watching for the signs and I will be proactive.

Stair-Step Pattern

There is a reason I spent so much time on the current set-up. Market rallies often transition into a stair-step pattern and this is the type of analysis you go through for each of the dips. This is what I would consider a "normal" rally with "normal" price action.

A stair-step pattern can be characterized as taking two steps forward and one step backwards. This might look like a fairly easy trend to trade, but it's not. You will notice that there are many pullbacks along the way. The size of the "stairs" is not uniform and each of them provides valuable clues on the strength of the rally. When the upward momentum stalls and the candle bodies are tiny, you should reduce your swing trades and you should expect a dip. As these candles form, you recognize that they are signs of selling pressure. The momentum has stalled and you are taking gains (reducing risk). You will notice that there are NOT many long bodied candles at the height of the bounces in the chart below. That means that the intraday ranges are compressed and these are difficult day trading conditions. The time to "spread your wings" is on pullbacks that find support. Those breakouts through the blue dotted lines are where you can get aggressive with short-term swing trades because there should be momentum for a week or two. Notice that we do not get many of those during the year. That means you have to strike when the iron is hot. Those gains might have to feed you for a month or more. We are throttling our activity based on where we are in the cycle. We reduce risk at the top of the bounce. We gauge the depth and duration of the dip. That is going to tell us how strong the trend is and how high the bounce should be. Brief and shallow bounces that last a few days are more bullish than deep drops that last weeks. We wait for support to be confirmed during the trough and we buy the breakout (blue dotted line). We are more aggressive on the brief and shallow dips than we are on the deep and prolonged dips.



Bull Market Transitions

Bull markets often transition into horizontal trading ranges. If the horizontal trading range is tight (compressed) and if it has come after a big rally, that is a pause. Buyers and sellers are temporarily in balance, but buyers are in control. The recent gains are holding and buyers are nibbling away at the supply (profit taking). In time, buyers will exhaust the supply and the next move higher will start.

In the final stages of an up trend, the market will lose its nice tight orderly pattern and the peaks and valleys will increase. The price action becomes “loose” and upward momentum degenerates. A trading channel results. There might still be a slight upward bias, but that will eventually disappear. Buyers and sellers are largely in agreement and neither side has the upper hand. Horizontal trading ranges can last for many months. The market is waiting for a macro catalyst and it will take time for corporate earnings to catch up to valuations. That could lead to an upside breakout. Perhaps economic conditions are gradually slowing while the market is in a sideways range. That might set up for a move lower. As a trader, you are gauging each drop and each bounce just like the real-time example I provided above. The price action will help us time the next move and horizontal trading ranges often have a rhythm to the cycle. In the weekly chart below, you can see how the market transitioned from bullish to neutral to bearish.

All good things must come to an end and bull markets will eventually transition into a bear market. It might take years for this to happen, but eventually it will. The macro forces that were in play have might take years for this to happen, but eventually it will. The macro forces that were in play have changed. Perhaps interest rates are rising or economic conditions are deteriorating. As long as the market is not concerned with credit conditions, you can expect very stubborn price action in the initial stages of the bear market. Bull markets die hard. The market spends much more time moving higher than it does moving lower. Buyers have been conditioned to buy dips. That means the first dip is likely to have a big bounce. There is no need to try to pick a market top. You need to wait for that lower high double top. Why? Look at every one of the dips in the chart below. I can guarantee you that there were shorts who considered each of those dips a market top. They shorted and those moves reversed sharply. Then they took huge losses.

When economic growth is declining, the Fed will lower interest rates and they will try to keep the “party” going as long as possible. That makes the transition from a bullish market to a bearish market more difficult to trade. Intraday ranges expand. That is good for day trading and it is not a good backdrop for swing trading because the market could go either way. Buyers and sellers are battling and the overnight moves in both directions are big. From a swing trading standpoint, the initial transition from a bullish market to a bearish market is a good time to keep your “powder” dry. As a short in a bear market, you are always fighting the Fed because they are adding liquidity and that causes big bounces.

The transition from a bullish market to a bearish market in the chart below happened over a period of months. At the end of 2021, the dips were deeper and they lasted longer (left side of the chart). This months. At the end of 2021, the dips were deeper and they lasted longer (left side of the chart). This was a sign that the selling pressure was increasing. On the last rally (middle), we saw a marginal new high and the big retracements from the high indicated strong resistance. This is when we went largely to cash (no swing trades). By the way, cash is a position. Market volatility was increasing and the long mixed candles told us that conditions were uncertain. The long candles depict big intraday ranges and we didn't have to swing trade. This was a great time to day trade and that was one of the primary transitions we made as traders. You can see that during 2022, it took a long time to discourage buyers. We finally had a technical breakdown and a lower high double top. Even then, we had to short when the bounces stalled and when they rolled over. The drops were fast and when there was a deep drop, we had to take gains during extreme weakness. If you overstayed your welcome, the bounces were violent. Once the down trend was established, there were swing trading opportunities on the short side, but you had to wait for the bounces to stall. This was not a market where you could just buy puts and let them ride. You had to actively manage your entries and exits.

Embrace The Red

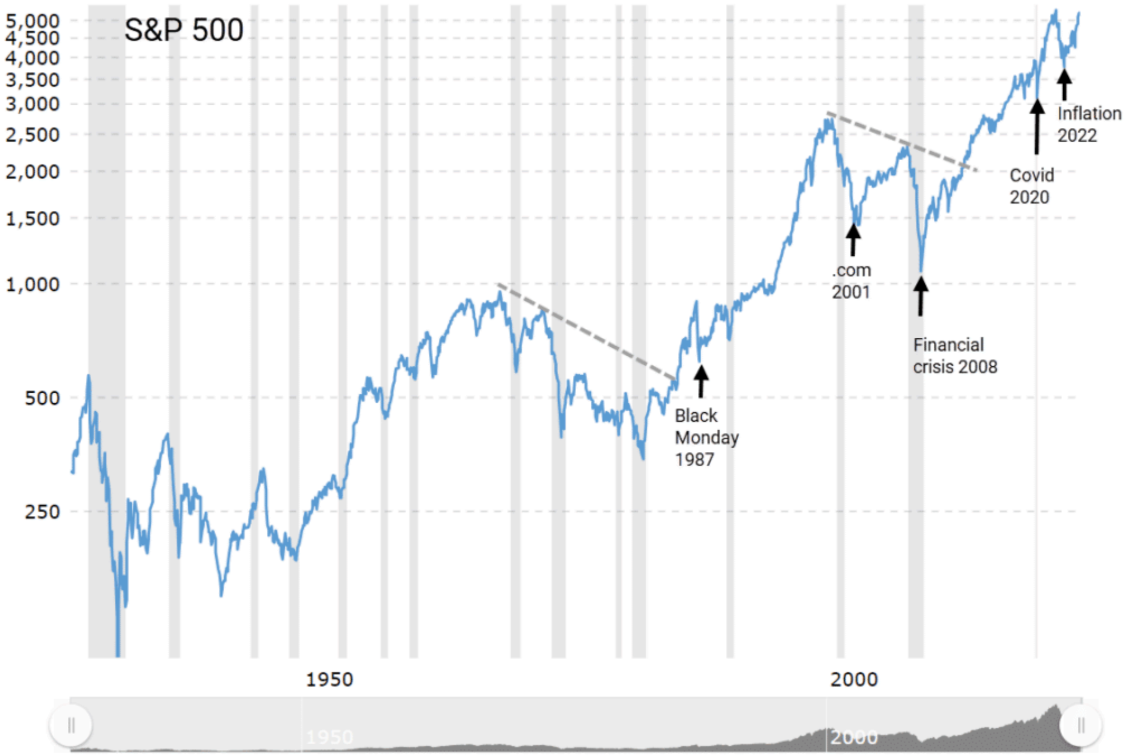
Many traders don't know how to short. They only know how to trade from the long side and they are washed out quickly. Some of them routinely sell out of the money bullish put spreads to generate income and that strategy doesn't work when the market is declining. Call buyers take a beating and they keep averaging down during the dips until they run out of money. Traders struggle to go from "buy the dip, buy the dip, buy the dip" to "short failed bounces, short failed bounces, short failed bounces." Their "buy the dip" mindset could have been deeply engrained over a period of years. Some traders have never experienced a bear market they have been deeply engrained over a period of years. Some traders have never experienced a bear market they are shocked to learn that the market actually does go down. Traders who are somewhat seasoned and who do short are surprised buy how fast and deep the drops are. Trading bear markets takes some getting used to. Traders also forget how violent the snap back rallies can be in a bear market. Instead of two steps forward and one step backwards in a bull market, the moves are more like three steps down and two steps back in a bear market. If you are not well-versed at shorting, you should work on it. Even in a bullish market there will be very weak stocks and you can short one share just to get a feel for it. Knowing how to short gives you greater awareness and you are able to see “both sides of the coin.” This will also prepare you for future bear markets.

Know What To Look For

If the market faces credit issues, the bearish price action will unfold slowly and it will seem like a normal bear market. If you start seeing financial stocks tank, that is a big warning sign. Credit is the oil that lubricates the economic engine and we don’t want that engine to lock up. Watch global interest rates. If there are credit concerns, they will start to rise quickly in problem countries. If you hear of bank failures, your guard should be up. The selling pressure will accelerate quickly and the drops will be very deep. The long red candles will start to stack and VIXX/VXX will shoot higher. These are gut wrenching times. The only good thing about them is that once you get short, ride those trades as long as you can. When option IVs spike, look for cheap options on stocks that don’t typically move much. Eventually, “the baby gets thrown out with the bath water” and they will fall. Take gains when you see the first bullish hammer off of a new low or a bullish engulfing candle. These moves lower will be deeper and they will last longer than you ever imagined.

We don’t have many trading opportunities where we can be mechanical in our execution. During the year, we might only have a few weeks where we can really ride trades and where the trend is strong. Those periods typically surface around short-term trend reversals. The rest of the time we are looking for clues and the market is transitioning. Sometimes the transition is from a strong trend to an upward sloping trading channel. Sometimes the transition if from an upward sloping trading channel to a horizontal trading range. We constantly monitor price action. Every dip and every bounce provides us with valuable clues. Brief shallow dips are more bullish than deep prolonged dips in the context of an up trend. Dips that are deeper and that last longer that the previous one are a bearish warning sign. If the dips increase in frequency, that is also a sign of increasing selling pressure. You are a race car driver and you are watching for curves and straight aways. You know when to take your foot off of the gas and when to floor it. You also know when to make a pit stop (cash).

To give you some perspective, we had a bull market from 1987 – 2001. Then we had a bear market from 2001 – 2003. Then we had a bull market from 2003 – 2008. Then we had a bear market from 2008 – 2009. Then we had a bull market from 2009 – 2022 (if you don’t count the Covid-19 crash which lasted a month). Then we had a bear market from 2022 – 2023. Bear markets don’t happen that often, but it’s important to identify them. They will wipe an account out very quickly. In the last 44 years, we have only been in a bear market for four of those years. Most of the time, we are trading flat or bullish markets. The character of the market does change and it is important for us to read price action and to adjust our game plan accordingly. This is a skill that you will develop over time.



Chapter 24: Don't Paint Yourself Into A Corner

Give your trades plenty of time to work out. Your entry won't be perfect and things don't always go as expected.

Trading is about control and we want to preserve it as long as possible. That's why we wait for technical confirmation before we enter a new position. Once we are in the trade, we lose some of our control and we are at the mercy of the stock and the market. We only trade the "best of the best." The multitude of marked "checkboxes" for every trade increases our odds of success and setting high standards for each position keeps us out of marginal trades. A large basket of trades is more difficult to manage/monitor and that reduces our control. When we sense danger, we don't hedge our positions, we exit some of them to reduce risk. Cash offers us maximum control and flexibility. Cash also gives us clarity. Instead of managing a large basket of positions, we are focused on reading price action and we are waiting for the next opportunity to set up. We have no emotional involvement when we have cash and we are ready to strike. These are some of the ways that we preserve our control.

This same concept applies to sports. When you lose your balance, you are not in control. That's when mistakes happen. You wait for your opponent to be off balance. That presents a window of opportunity and that is when you strike.

Time impacts our control. There are scheduled events that we can predict. As they draw closer, these events reduce our flexibility and our control. We don't want to be forced out of trades just because the event is approaching and we need to plan around it. Here are some situations you should avoid. These timelines will force you to act and they will limit your control.

Day Trading Too Late In The Day

When we day trade with less than an hour left in the day, we don't have time for the stock to move around. It has to perform immediately. If it is a day trade, our intention is to get out of the position by the end of the day and too keep our overnight risk to a minimum. Price movement in the last hour of trading is often choppy and there is no reason to force these trades. Time is working against you. If the stock moves against you, it doesn't have enough time to recover and you are forced to take the loss.

Pattern Day Trading Rules (PDT)

Many small accounts fall under PDT because they have less than $25,000 in the account. Traders know that they can exit 3 trades in the same day in a 5 day period. If they violate that rule, the account will be restricted until there is $25,000 in the account. Traders who have exited three trades already are forced to hold positions overnight. If the trade is moving against you, this is a big risk to take. You have no control!

Leveraging The Entire Account

This can happen to day traders who use 4X buying power to enter stock positions. If the stock moves against you, there is no way for you to hold that position overnight. You don't have enough money to do that. Again, you have relinquished control. If you are going to leverage to this extent, you had better make sure that your entries are excellent. You can't afford to have the position move against you. Day traders also need to enter leveraged stock trades in the first half of the day so they have time to recover if something goes wrong. Swing traders also have an issue when they overleverage. Let's say that you sold naked puts on a stock that you intend to buy. The margin you have to put up (20%) is much less than the margin you would have to put up to buy the stock on margin (50%). The stock tanks and now you can't afford to buy it. You have to buy the puts back for a loss and you are not in control. Using an entire account also limits you from taking advantage of new trades. You don't have enough cash in the account so you will miss those opportunities.

Taking Positions Before Big News Events

If you are entering trades before the FOMC Statement or a major economic release that has produced big moves, you are compromising your control. Your window of opportunity is closing and the stock has to moves, you are compromising your control. Your window of opportunity is closing and the stock has to perform right away. The position doesn't have time to move around. It has to perform right away. If it's a losing trade, you will be forced to take the hit. Some traders will hold the position into the event because they don't want to take the loss. Now they are compromising their trading discipline. They have identified that a pending event creates uncertainty and that they need to reduce risk ahead of it. Now they've decided to abandon their game plan. They are no longer in control and risk is elevated.

Buying Options That Expire Too Soon

"Hey, XYX looks like it is going to fly. I think I will buy some calls. The weekly at the money calls look good. I can buy more of these and the options a few weeks farther out are "too expensive." Besides, I am not going to hold this position for a few days so time decay will not be a big factor." This is the logic most traders use. I see it all the time. You are not giving the trade any latitude and time is your enemy. These options are going to expire in a week and time decay is going to be working against you. If anything goes wrong, you are screwed. An overnight market hiccup, an earnings release from a peer or an analyst downgrade can push the stock down temporarily. Perhaps the stock has run hard to get through resistance and it just needs to rest for a few days. You can't afford to have this happen. The stock can't sit still and it certainly can't retrace. It has to move higher right now or you are going to lose money. In this instance, you have very little control. The options expire worthless and then you watch the stock continue higher. This will leave a mental scar.

Trading Ahead Of Earnings

We don't hold positions over earnings announcements. This is a binary event and our odds are 50:50. These are not the odds we want and we know we need to exit trades before the earnings announcement. If you are taking a swing position a few days out from the announcement, you have very little flexibility. You can't afford to have the stock move against you. There's no time for it rebound and you have to be out before the number. You can take this example to the extreme by day trading stocks that announce earnings after the close or before the open the next day using 4X day trading buying power. You are painting yourself into a corner. Stocks that are about to report earnings are often very volatile the day before the announcement. Institutions are squaring positions based on their expectations. There are buyers and there are sellers. That increases the volatility. Stocks that look great one minute suddenly change their character. Avoid swing trading stocks that announce earnings in a few days and don't day trade stocks that are going to report earnings overnight. You are giving up too much control when you do this.

Quitting Your "Real Job" Too Soon

Your primary income is essential when you are learning how to trade. It will provide you with a safety net. If you go through a rough patch, you won't have to worry about paying your bills because you have a steady income. If you go through a losing streak, your primary income will give you the ability to earn that money back. You can learn at your own pace and you are not forcing yourself to perform immediately. When you quit your "real job," you are giving up some of your control.

Not Planning For Expenses

Some traders have borrowed money to fund their trading account. It might not be from a friend or a relative, it could be money that is “ear marked” for upcoming expenses. Income taxes, property taxes, a home remodeling project, a new car or other “big ticket” items would qualify. You know when these expenses are due and your account is not as big as you think it is because you have borrowed money that you will need. When you are forced to take money out of your account, you will have to liquidate positions. Borrowing money to finance your trading is never a good idea because it is not money that you can afford to lose.

Trading Ill-Liquid Stocks Or Options

Traders will often trade momentum stocks that have wide bid/ask spreads. Traders can and do trade them using 4X intraday leverage. These stocks are so volatile that you have to give them some room to move around. If the stock moves against you, it will be more difficult to exit because the bid “drops out” quickly. Now you are left holding the bag. You are hoping that the stock comes back because you will be forced to exit the position. You don’t have the capital you need to hold it overnight and you do not control the situation. The same is true for ill-liquid options with a wide bid/ask spread. You are always at the mercy of the Market Maker and you will exit at a price that is attractive to the Market Maker. There is often no one else trading these options. You might think that selling an out of the money bullish put spread will not be an issue because you won’t have to exit the trade. It will expire worthless. That’s fine if everything goes according to plan. When it doesn’t go according to plan and you need to close the trade, it will be very difficult. You also will not be able to “leg out” of the position because the bid/ask on each leg is so wide. This reduces your flexibility. Stick with liquid stocks and liquid options and stay in control.

We are in control until we enter the trade. Once we enter the position, we are at the mercy of the market and the stock. Hang on to that control as long as you can. The issues I’ve mentioned in this article will also impact your control. Avoid these situations and “don’t paint yourself into a corner.”

Chapter 25: Rigid Thinkers

As traders it is important to be confident, but not rigid. We always need to see both sides of the coin and we need to leave room for error.

We gather data, we analyze the data and we draw conclusions. Then we assess which outcomes are most likely to happen and we act when the odds are high. If the odds are not high, we continue the process information until they are. The market is dynamic and we should not expect that we are going to predict market direction correctly every time. That is why we take starter positions and we only add when we have technical confirmation. Traders continue to gather and analyze data through the course of the trade and they make adjustments to their forecast. It’s important to remain flexible and to analyze new data objectively. Try not to view it through the lens of your current position. Many traders struggle with this and they only see what they want to see.

There is a fine balance between being confident in your analysis and being rigid in your thinking. On one extreme we have the Flip Flop Trader. They don’t have confidence in their analysis and their forecast changes every time the wind blows. They are constantly in and out of positions trading from both sides. On the other extreme, there are rigid traders who act with extreme confidence and they operate in absolutes. Some of this might be explained by their personality.

Perma Bull

This trader only sees the market from the long side. In their mind, it only goes up. Given that the market does spend most of its time going up, this is not the worst camp to be in. They tend to be optimists and they are always searching for reasons to buy. This is not an issue for investors who do not use leverage and who have a very long-term horizon. They can ride out market drops and they can dollar cost average with confidence knowing that eventually the market will come back. Traders do use leverage and this approach will eventually wipe out an account. When the market drops, the trader is forced to liquidate the positions for a large loss and their trading career is over. Bull markets can last for a decade and many traders have never even seen a bear market. They don’t know how to short and they can’t see both sides of the coin. Let’s suppose the S&P 500 was down 30% in the last year. These traders were bullish at the top and all the way down. Every single failed bounce along the way was a buying opportunity in their eyes. They kept averaging down and now the account is in peril. Since we are trading and not investing, it is critically important to stay objective and to recognize selling pressure. Many traders refuse to short stocks and they are “long only” traders. If you fall into this camp, you had better learn that cash is a position. There will be times when you need to go to the sideline and wait for the market to drop. Then you need to wait for a base to form over a period of months and you need to look for higher lows. Only then you resume your trading. Every trader should learn how to short. It will increase your clarity/perspective and instead of being sidelined, you will make money during the decline.

Perma Bear

These traders have made money shorting. It’s the only way you can become a “Perma Bear.” They relished the thought of making money when there was panic in the streets. Everyone else was losing money and they were making money. The know that the market “takes the stairs up and the elevator down.” They made a lot of money shorting and they can’t get it out of their minds. The profits came quickly and they want to find those opportunities again. These traders tend to be pessimists and they are always looking for a big drop. Every dip off of a new relative high is a market top and they are ready to short. These traders know that when the move comes, the action will be fast and furious. The market could be up 30% in a year and these traders have been picking tops (shorting) the whole way up. I could name names, but I won’t. There have been many have been picking tops (shorting) the whole way up. I could name names, but I won't. There have been many analysts that got a crash right and they made a name for themselves. Then their true colors showed. They were "Perma Bears" and they were constantly predicting a global credit crisis. The market soared to new all-time highs and they were still beating the same drum. As the saying goes, "Even a blind squirrel can find a nut from time to time." The market goes up a lot more than it goes down. "Perma Bears" are destine to fail.

Perma Fade

This guy is always looking for an argument. If you say black, he says white. He could be blind and it won't matter. He just wants to take the other side of every bet. If the market is in a strong up trend, he is looking to fade it. "It's over-extended." Then they will find every reason they can to short. If the market drops, he wants to buy. "This is a great entry point." These traders can do well in a sideways market, but they will get crushed during a trend. This personality sets up better for scalping because they tend to change their opinion often. If they can get in and out quickly they will do fine, but the underlying has to be trapped in a horizontal trading range. As soon as the trade starts to gain traction, they take gains and they are actually considering a short. It's crazy, but I see this all the time. These traders will NEVER catch a trade and ride a trend. This is where the big money is made. You don't just ride the trade, if the trend is strong, you add to it on confirmation and you build a big position.

It's never good to have a rigid mindset when you are trading. Market conditions change constantly. If we continuously gather data and we process it objectively, we can adapt and adjust. We are trading based on the current odds based on the information we've processed to this point and the odds are never 100%. We leave room for error and as new information is presented, we factor that in and we adjust the odds. Then we act accordingly. If you feel that you have a tendency to fall into one of these three categories, identify the issue and then work on ways to break that mindset. Write detailed trade logs and get the problem out in the open. Then include possible solutions in your future game plans.

Chapter 26: Trading Options Too Soon

This double-edged sword cuts very deeply and you will lose money at a faster rate if you do not know what you are doing.

Even though the Options Analysis section appears before the Common Mistakes section in the course, it was the last one I wrote. More than 90% of this content was written without even mentioning options. This should give you some idea of where options fall in the overall trading spectrum. They are the icing on the cake.

You've probably heard that options are the best thing to happen to trading. Imagine a product where you can make money if the underlying goes up in price, stays flat or goes down! People are making 200% and more per trade. How exciting! This is a sure-fire way to take your tiny account and to grow it quickly. Oh yes, I forgot to mention one of the favorite "buzz words." Your risk is limited. OMG, you mean to tell me that all I can lose is 100% of my investment? Yes! Well… sign me up, what a deal!

There are "gurus" who want to sell you their "option trading secrets" for a small fortune. They will throw big works at you like intrinsic value, time decay, implied volatility and delta. Surely these folks are smart. They make options trading sound like the solution to all of your trading problems.

Novice traders like to brag about their "big winners" because they want to impress you. Monster percentage gains from options trading are just the way to do it. By the way, you never here them brag about their losers. If you happen to see these folks six months later, there is a good chance they aren't trading options… or anything else. "Gurus" know that they have to promote big percentage gains to lure you in. You start thinking of how much money you are going to make. Do you really believe that your path to riches is through someone else? Apparently, some people do or these guys would not be spending a ton of money on advertising.

There are options software programs that will tell you the optimal strategy to use for a trade. Surely these will help you to be successful. They could, but here's the missing element. You have to accurately forecast the market D1 and the stock D1. That forecast will need to include direction, speed and magnitude for the market and the stock. That's the issue. You are a novice trader and you don't know how to do that. Don't feel bad, most "gurus" don't know how to do that either.

Options Are The Icing On The Cake

Options are the pinnacle of trading. They are the very tip of the pyramid. Before you can successfully trade options, you have to learn everything in the base of the pyramid. If you don't know what you are doing, options trading will just speed up the rate at which you lose money.

"But Pete, what about selling naked puts on stocks I want to own?" If you are willing to buy the stock, go ahead. Just make sure you hold 50% of the strike price in reserve and make sure you know how to pick good companies. This is an investment strategy. There is still thought and research that has to go into this. If you don't pick good stocks, you will be left with a basket of garbage.

"But Pete, there is a delta neutral trading strategy where I don't need to know the direction, duration or magnitude of the move. It sells naked straddles and iron condors." Wonderful. You've found a way to get rich and you don't have to know anything. Do you really believe this?

"But Pete I'm poor and I don't have enough money to trade stock. Options are all I can afford." Have you learned a trading system for years and paper traded shares? Is your win rate greater than 75% for a few months consecutively? Have you paper traded options? Be careful even if you have. Some of the paper trading option fills are not realistic. If you have, you might be able to give it a try on a very small scale. Small accounts are very difficult to grow and I wrote about that.

The problem is that novice traders have not gone through the process and they have not hit the performance metrics they need to trade options. They just want to rush in and prove that they are the exception to the rule.

Even if you have successfully traded stock with a great win rate, the transition to options takes time. If you get the timing wrong and the strategy wrong, the options will expire worthless and you will lose money. If you had just traded the stock, you would have made money. It takes time to learn which options strategy to use and when to use it. Know that you don't even have to trade options to be a successful trader.

Don't rush your options trading. You will burn through your capital quickly and for most novice traders, their first options trading experience will be their last trading experience of any kind.