How to Make Money Shorting Stocks in Up and Down Markets

Now I am very much aware that many market players do not like to short stocks. This bias against the short side of the market is totally understandable, especially given the fact that the widespread reluctance is garnered and perpetuated by the various exchanges and the other powers-that-be. For example, one can only short a stock if it is trading on an uptick. That one rule makes getting shorts off (filled) extremely difficult in declining markets. The reason for this handicap of course is to prevent traders from adding to the selling pressure. Yet there is no bias of that nature directed against the upside. The exchanges seem to have very little problem with the market rising in an unfettered fashion.

Now, the number of stocks that can be made available for shorting, even if they are trading on an uptick, is being limited by the exchanges. This further handicaps the short seller, and clearly makes it known that the powers-that-be don't want the public shorting. I don't know about you, but whenever the higher-ups say "No, we don't want you doing that," I ask, "Hmm, I wonder why they don't?" That's me. I'm a questioner. Always have been. Always will be. It's the way I'm wired, I guess. Of course these rules are said to be for the benefit of the "average investor," whatever that term means. But we as professionals know this to be untrue, at least to a certain extent. These hindrances or barricades to the world of shorting are to protect one of the last areas of really big money. Small fortunes (and some not that small) are made everyday on the short side of the market by those professionals who do not have these restrictions imposed on them.

A Specialist on the American Stock Exchange (AMEX) does not have to wait for an uptick to get short. Neither does a NASDAQ market maker, for that matter. Again, my nature compels me to ask, "Why? Why can they and not us?" It's the same age-old reason, my friends. Money. Big money. And instead of the little guy being let in on it, he is being kept out, or at least discouraged, all in the false light of "protection." The public is being duped again, and many are buying it. "Why short when the market is going up" is the loud cry we hear from the establishment. Yet it's the establishment who has conveniently made sure they are free of these restrictions in this up market. I smell a rat! And the stench is incredible.

The Theory

Stocks that are up robustly on the day, and actually close near the day's high, are no doubt very strong stocks. In fact, this strength, particularly if a lot of it occurred near the day's end, will typically lead to immediate upside movement the following morning. The reason behind this upside tendency is quite simple, though relatively unknown. Many people forget or do not realize that the job of a NYSE specialist or NASDAQ market maker is to provide liquidity. This means that if a stock is falling and there is an absence of buyers, they must buy. Conversely, if a stock is running up quickly and there are no sellers to offset the buying, they must take the other side as sellers. This often times puts the specialists and the market makers at odds with the trend and or the current momentum. In many cases, the specialists and the market makers will actually sell so much of their inventory (personally owned stock) on the way up, that they become what the industry terms, "net short." This simply means that they have sold more stock than they own and will have to buy the stock back lower than their average short price if they are to make money. Therein lies the key to our philosophy. With specialist and market makers (large firms backed by enormous amounts of money) short, they have a vested interest in the stock dropping so that they can cover their open short positions at a profit. And believe me my friends, they will do everything in their power to make it happen. Otherwise they will lose, which they do at times, and lose big. This is where we come in.

The Approach

The focus of our approach is to join the well-capitalized professionals (the specialists and/ or the market makers) precisely when they are the most interested in the stock going down. In other words, we only want to think about shorting when these heavy weights are also rich with open short positions. This dramatically increases the odds of our being right. To this end, we have devised a very simple yet powerful approach to let us know when to strike on the short side. We are proud to say that the approach enjoys a very high degree of accuracy, and as mentioned above, is predicated on what the big money will be doing. Let's take a closer look at what's required to use this professional technique.

The Tools

1) A daily price chart which displays roughly three to six months of price data. As many of you know, we rely on the price chart to reveal the flow of money. An upward movement in the price chart shows buying and a downward price chart reveals heavy selling.

2) Standard Bollinger Bands (20 period exponential bands with 2 standard deviations). This technical tool can be found in every commercial charting package on the market. Even sophisticated order entry systems like **Mastertrader** and Real Tick III which give traders near instant fills will have this study included. Let's move to The Set-Up.

The Set Up

1) The stock must first puncture and close outside (above) the upper Bollinger Band. The closer the closing price is to the high of the day, the better. And the bigger the day's advance, the better. As a general rule, you will want this day's bar to be at least $2 or more in length from high to low. This is not always necessary, but it's better to have it.

2) On the following day, the stock must "gap" down below the prior day's close. This "gap down" is crucial as it serves as the most important criteria of the entire strategy. If the stock does not open for trading below the prior day's close by at least 50 cents (preferably more), no action should be taken. We need weakness right at the open. Example: If on Tuesday the stock closed at $40, we want to see the stock open for trading on Wednesday no higher than $39.50. It must open down!

Note: In many cases, this gap down will be caused by either an exceptionally weak market open or a negative news item on the company, such as a brokerage downgrade. But in either case, the gap down signifies major selling (profit taking), and the pros who short will be loving it. Keep in mind that both the above criteria must be met before action is taken.

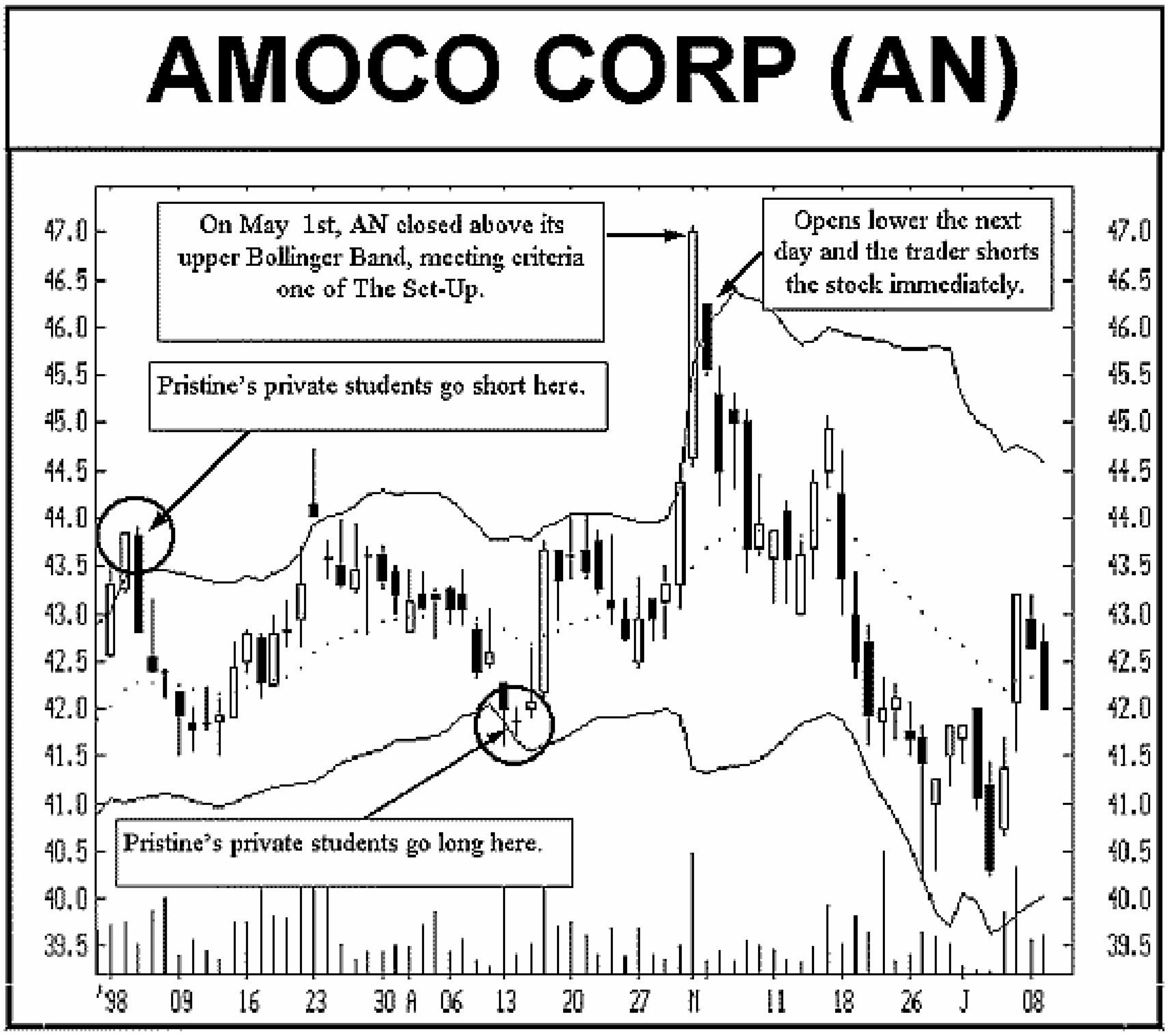
The Action

Once the above Set Up Criteria is met, the trader will do the following:

1) Sell the stock short (at the market if you have the luxury of being able to kill the trade instantly in the event the stock gets too far away from you). With order entry systems like **Mastertrader**, the trader will be able to instantly cancel the open order, if need be. If the trader lacks this "instant canceling" capability, he is better off placing a limit sell order.

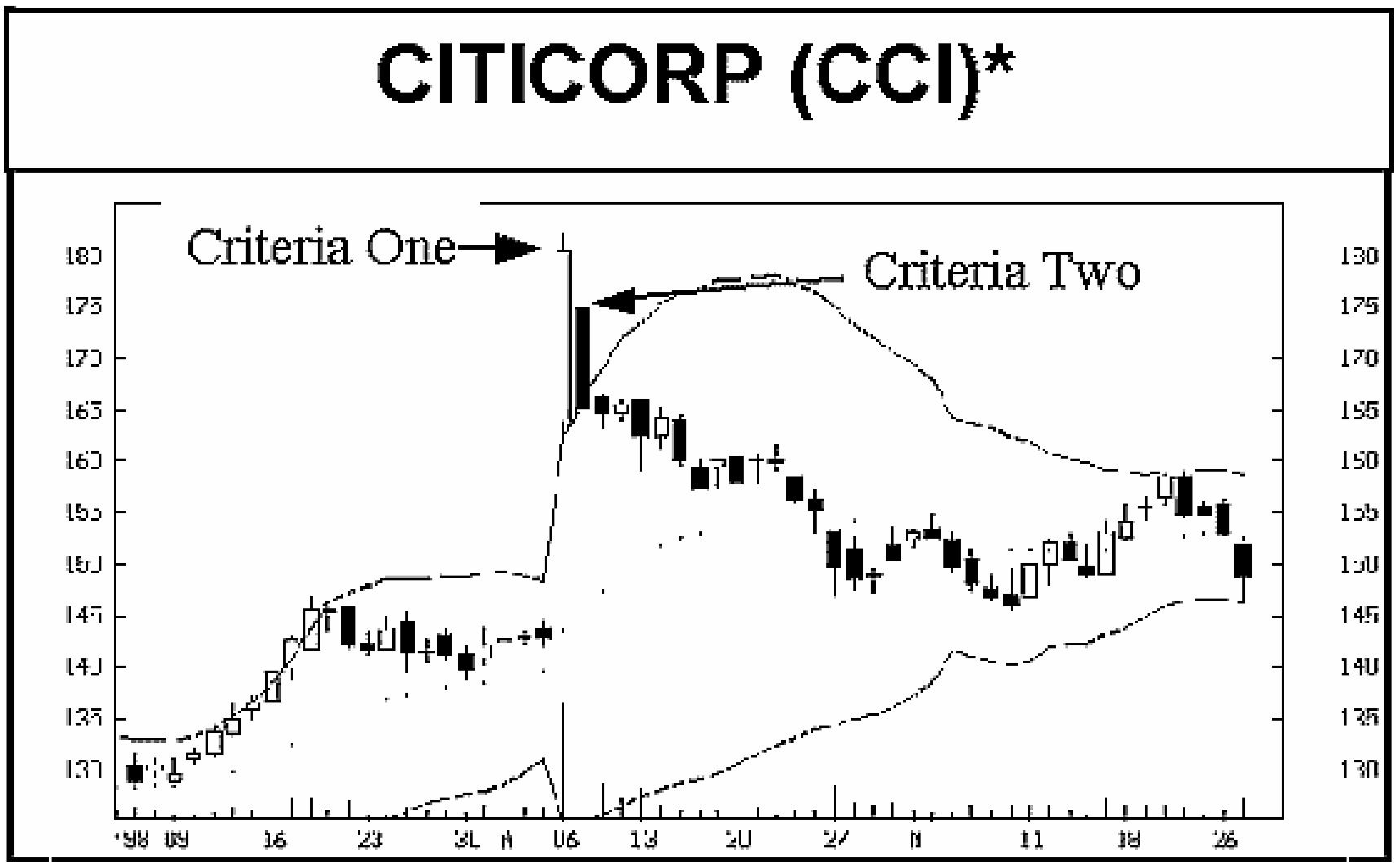
2) Once the short has been filled, place a protective stop (mental or otherwise) 1/8 above the high of the prior day. This is our insurance policy against disaster. If the stock rises above the high of the prior day, that is our sign that the shorts are being squeezed, and the major advance has more steam left, as those short will be forced to buy at higher prices to curtail their losses.

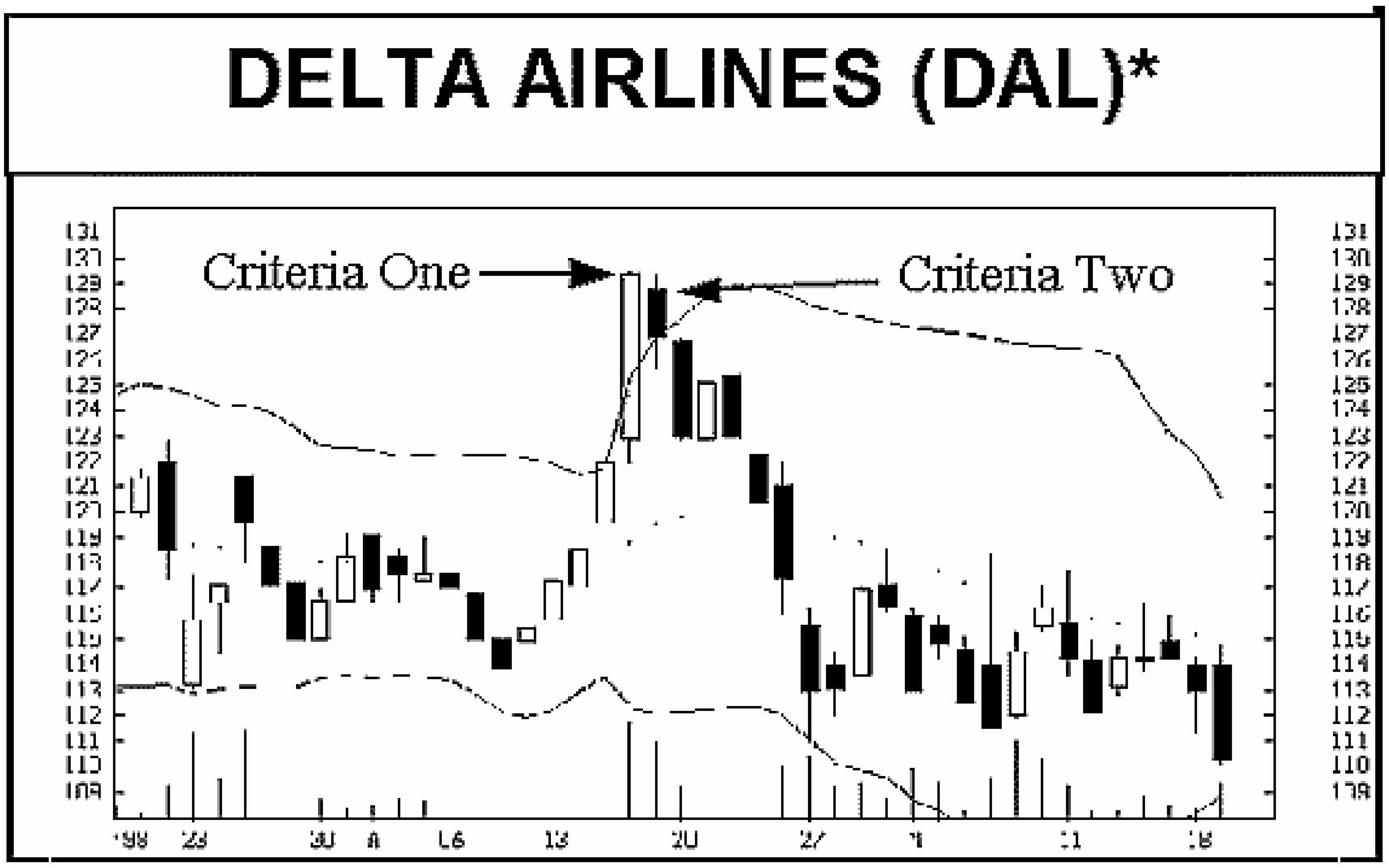
3) Hold for two to three days or more, protecting your profits on the way down with some form of trailing stop methodology. Note: Some traders may want to move their protective stop 1/8 above each prior day's high. This is called "tracking the prior highs." Others may want to "book profits" in the following manner: "Once up $1, move stop to break-even. Once up $2, protect 1/2 of the gain, and once up $3 or more, protect 2/3 of the gain. Note: The idea is to ride the short for maximum profits. But of course if the trader is shorting a weak stock in the context of a bullish market environment, booking the profits sooner rather than later is preferred, even if it means missing additional gains. We don't want to fight the major flow of the market too long. A few examples will make this clear.



Amoco Corp (AN), a multi-national oil & gas company, topped out in a very big way in the beginning of May 1998, and astute traders who were able to detect the dynamics at play capitalized on the ensuing down move. As shown in the above price chart, AN rallied very strongly on Friday, May 1, 1998 and managed to close at $47, well outside its upper Bollinger Band. This bullish move perfectly met criteria one of our short strategy. As you can see, on the following trading day, which was Monday, May 4, 1998, AN opened at $46.25, well below its prior day's close of $47, helping it to meet the second and final criteria of our shorting strategy. It is at this point the Pristine trader would sell AN short with a stop at $47 3/16, which is 1/8 above Friday's high of $47 1/16. Once the Pristine trader gets short and has his stop in place (mental or otherwise), he sits back and relaxes, making sure that he manages his open position with some form of trailing stop method. See comments under The Action on page 3. AN went on to fall as low as $40.25 before it regained its strength. Note: The circles on the chart show other short and long opportunities that many of our private students would have capitalized on, as they met the criteria of other reliable Pristine Trading Tactics. For more info regarding how you can become a private student of Pristine, please call toll free 1-877-999-0979. A representative will gladly help up. In the mean time, let's take a look at a few other examples to drill home the accuracy of this technique.

How to Short Stocks Like a Pro!





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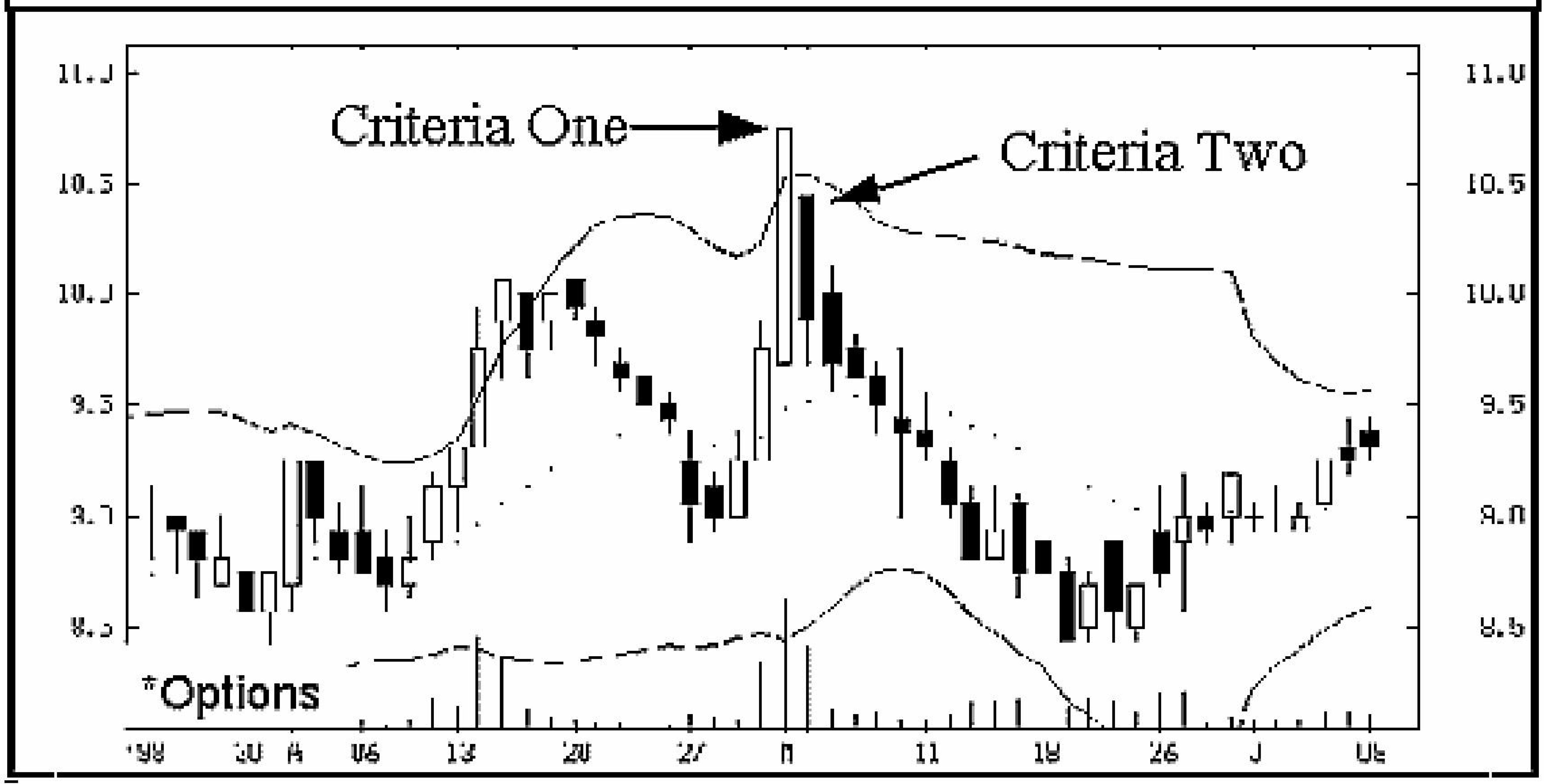
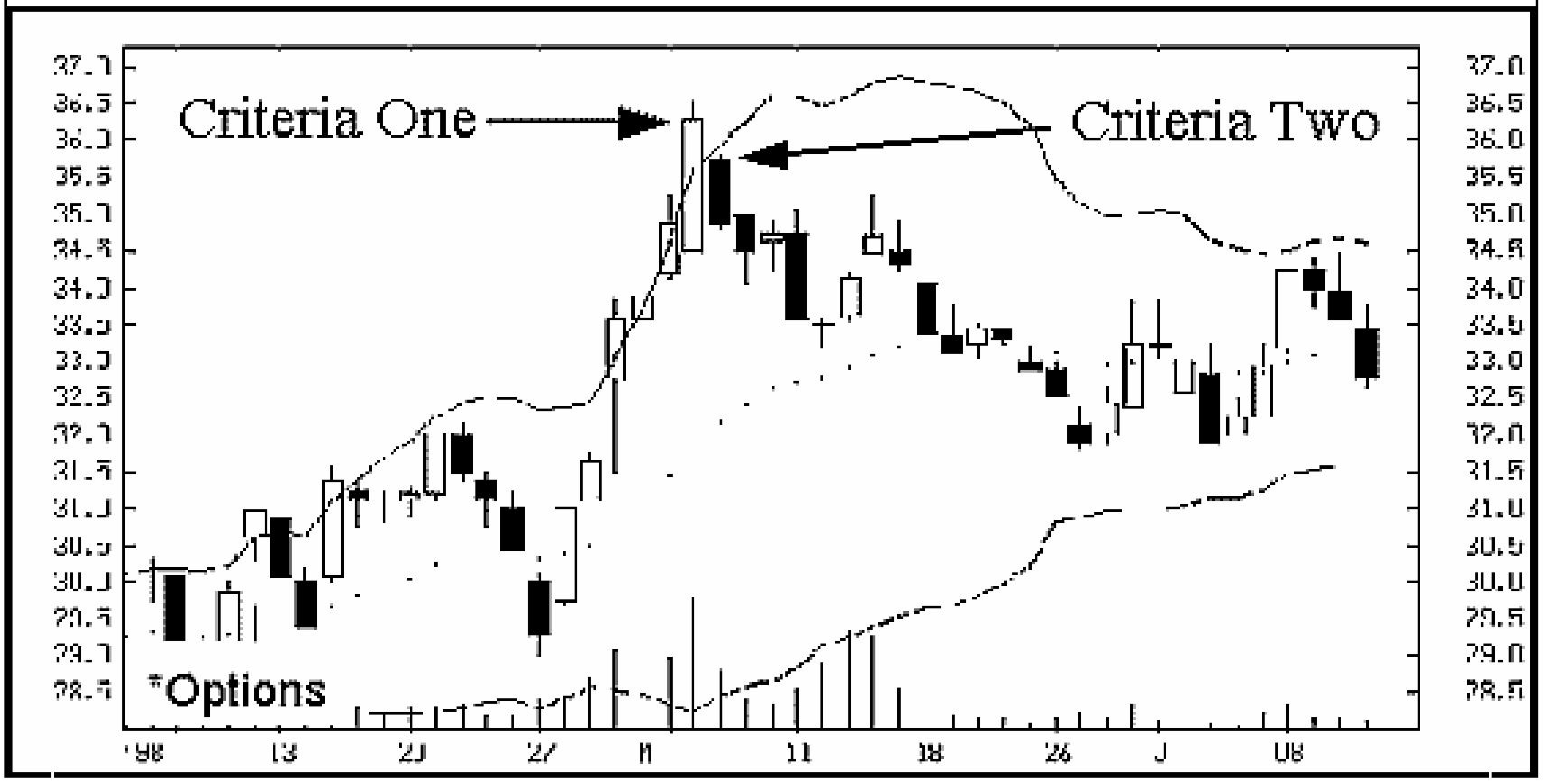


LIMITED CORP (LTD)*



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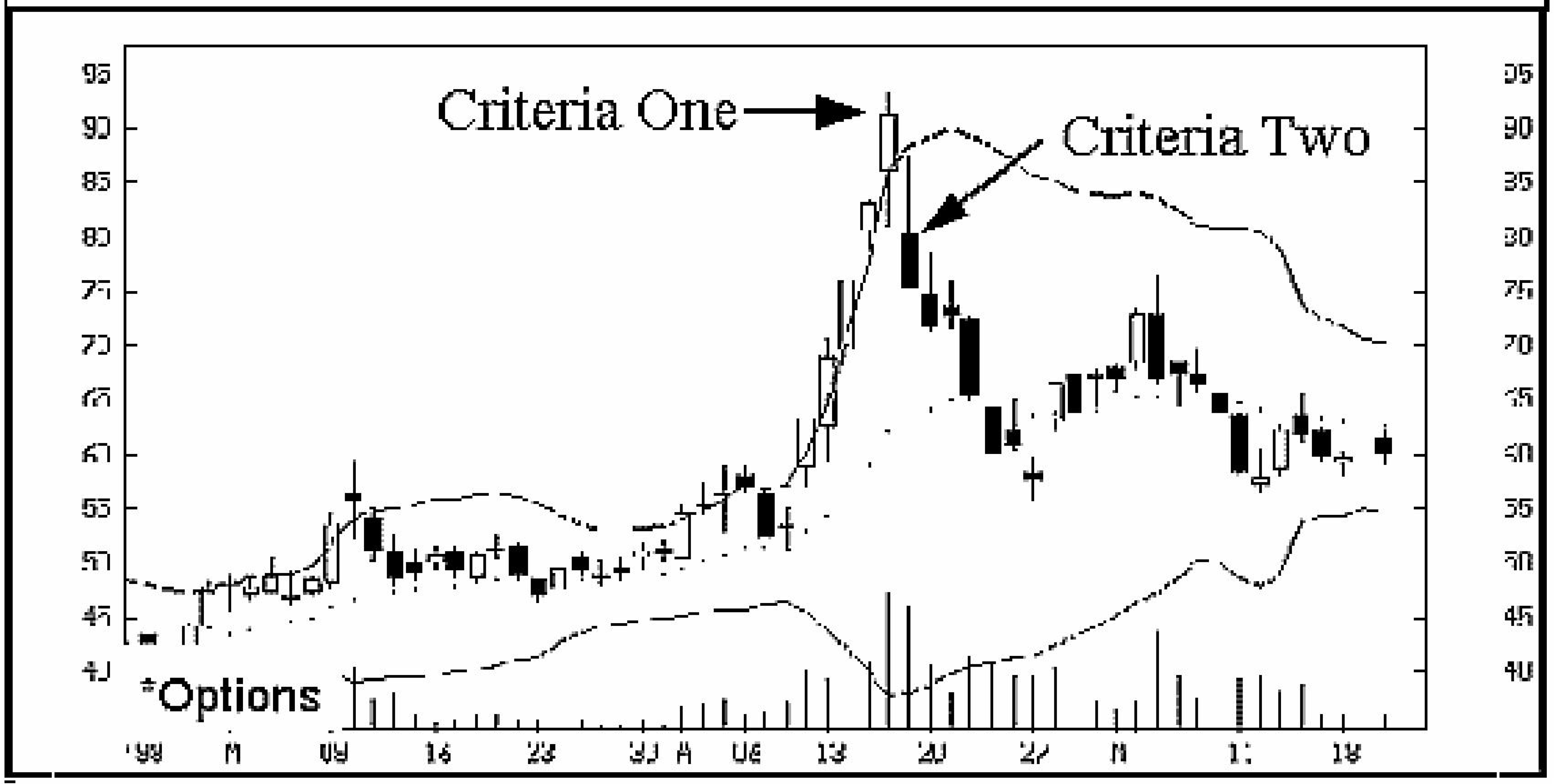

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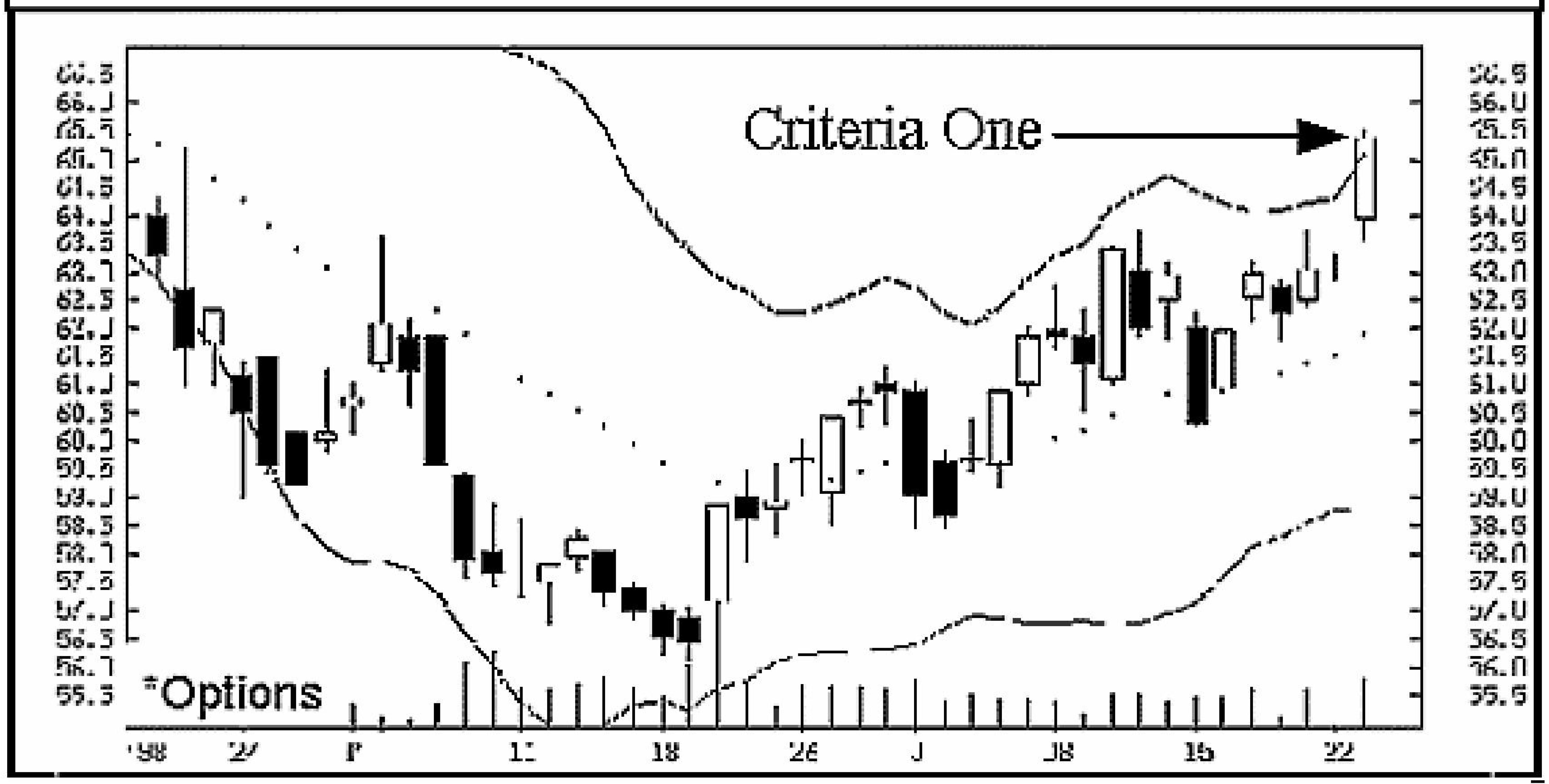

The above examples should drive home how accurate our short technique is, and how robust the gains can be, if handled as we outlined in the previous pages of this report. Note: Some of the above plays were outlined in the Pristine Day Trader, many were mentioned in our Real-Time Trading Room, but most were simply capitalized on by our private students who know "what" to do, "how" to do it, and most importantly, "when" to do it. As mentioned before, if you wish to receive information on how to become a Private Pristine Student (PPS) or you'd like to attend our next one day Trading Boot Camp, please call toll free 1-877-999-0979. Let us help you make your journey to the high lands of trading mastery easier and shorter. Well, there you have it. Your key to making profits on the short-side, just like the pros!