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electronic
day
trading
to Win

**REAL
TACTICS FOR
REAL PROFITS
— ANYTIME,
ANYWHERE!**

BOB BAIRD

electronic day trading *to win*

**BOB BAIRD
CRAIG McBURNEY**



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preface

Day Trading Defined

We hear more and more these days about “day trading,” whatever that is. It’s getting to the point where every time you turn on a business TV or radio program, there is a segment or series about something that the reporters call *day trading*. After listening for a few moments, it becomes clear that few of those reporting on this new phenomenon have little more than the vaguest concept of what they are talking about. Fewer still are members of the audience who do. These segments run the gamut from calm and evenhanded to frantic apocalyptic warnings about looming financial disaster should you dare to touch, much less eat, the forbidden fruit of day trading.

Perhaps you have picked up this book with a certain preconceived notion about what day trading is, probably based on reports you may have seen, heard, or read. Of course, under the loosest, broadest definition possible, day trading means simply that you buy and sell stock on the same day, no matter how the purchase or sale is accomplished. Unfortunately, because trading electronically, by whatever means, is so new, it is also widely misunderstood. Media reports on day trading provide little in the way of making the vastly important distinctions between the three primary venues, electronic, online, and broker-assisted, by which day trading can be accomplished. Instead, by lumping together a conglomeration of these diametrically opposed means of day trading, they throw the whole matter into hopeless confusion, and the term *day trading* effectively becomes meaningless. Their general philosophy is like that of the Mad Hatter, “When we talk about day trading, it means exactly what we want it to mean. No more

and no less.” We, however, should respond as Plato would: “If you wish to converse with us, define your terms!”

Let’s therefore summarize the major differences between the three types of so-called day trading so that the advantages of electronic direct-access trading (what our book is about) may become clear by contrast. When you trade through a broker, you (1) pay commissions ranging from moderate to very high, (2) have no access to real-time data, (3) have

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EDITOR'S NOTE: "THIS COUPLE HAD CLOTHES ON BEFORE THEY MET HIM."

very slow execution time, resulting in poor fills because stock prices can change between the time you talk to your broker and when the trade is executed, and (4) lose the *spread* (difference between the bid and ask price) because your broker buys, say, at $25\frac{1}{4}$ per share (*bid*) and sells to you at $25\frac{1}{2}$ (*ask*). That's \$250 on a 1,000-share trade! The very slow execution time results because the broker has to send the order to the firm's trading desk, the trading desk then routes the order to a *market maker*, and, finally, the market maker makes the trade. Someone who calls himself a day trader, yet is trading via a broker, is like a mechanic whose tool set consists of a screwdriver and a pair of pliers.

When you trade through an online broker, you (1) pay commissions ranging from low to moderate, (2) sometimes have access to real-time data, but no one tells you what to do with it or how to use it, (3) still have very slow execution time, resulting in poor fills because stock prices can change between the time you push the button to enter your trade and when the trade is executed, and (4) lose the spread because your online brokerage buys, say, at $25\frac{1}{4}$ per share and sells to you at $25\frac{1}{2}$. The very slow execution time results because you push a button that sends the order to the firm's trading desk, the trading desk then routes the order to a market maker, and, finally, the market maker makes the trade. Thus, the only real differences between broker trading and online trading are that, in doing the latter, there is no broker to ask what in the world is going on when the trade goes awry, and sometimes you save a few bucks on commissions. Someone who calls herself a day trader, yet is trading online in this manner, is like a mechanic whose tool set consists of a screwdriver, a pair of pliers, and a hammer.

By contrast, with electronic direct-access trading, when your day trading is tied directly into the markets, as we will discuss in detail, you (1) pay moderate commissions, (2) have access to real-time data and know how to use it, (3) have instantaneous executions, resulting in good fills because stock prices change little between the time you enter your trade and seconds later when the trade is executed, and (4) have the ability to buy on the bid ($25\frac{1}{4}$, in our example) and sell on the ask ($25\frac{1}{2}$). Your rapid fills are possible because you are bypassing not just the broker, but the trading desk and, often, even the market maker. The advantages of electronic direct-access trading are overwhelming, as you will see. Someone who is day trading with direct market access is like a mechanic whose tool set consists of a five-foot-tall red toolbox on wheels, with 30 drawers and hundreds of specialized tools for any contingency. Which way, then, do you want to trade?

Let's think of it this way. Trading in any manner, day or otherwise, through a broker is analogous to having a 1,200-baud modem and using it to communicate with someone else who also has a 1,200-baud modem. Moving "up" to online trading is like getting a 14.4K modem and using it to communicate with someone who has a 1,200-baud modem. Trading with direct access to the markets is like having a cable modem and using it to communicate with someone who also has a cable modem. As you can see, no matter how fast a modem you might have, 56K, cable, or whatever, it makes no difference at all as long as the person on the other end is still using a 1,200-baud one! This is why the typical online trading is nearly as outmoded in every respect as regular call-your-broker trading, and why so few are making any money doing either. If the term *market order* characterizes much of your previous trading history, then, unquestionably, our book is for you!

What This Book Will Do For You

By studying our book, aspiring day traders will learn the details of day trading stocks with direct market access. We will cover how all of this is possible, a brief history of SOES, the Nasdaq marketplace, compliance with applicable Nasdaq and SEC regulations, the various order-entry systems, the psychology of trading, news and its impact on the marketplace, technical analysis, computer trading screen setup, the trading day, and, lastly, several of the numerous trading strategies and styles that you will want to consider and take advantage of as a day trader. Upon completion of our book, aspiring day traders will have a firm foundation in and understanding of the dynamic processes working within the securities marketplace. By using the knowledge so gained, aspiring day traders may embark on a rewarding and potentially quite lucrative career day trading equities on the stock exchanges.

Finally, whenever we introduce important new terms, we will give an explanation of them and italicize them to indicate that these words appear in the glossary. As you progress through our book, you will encounter these words from place to place, and you can refer to the glossary if you need a reminder about their meaning. The index will give the page numbers on which a given term appears throughout our book, so that you may use our book as a ready reference and can refer back to specific concepts to refresh your understanding. Using a PC, a modem, a phone line, and specialized software, you can now trade

securities directly on the stock exchanges instantly, with a simple click of the computer mouse. The purpose of our book is to show you how.

An old Chinese proverb tells us that when the student is ready, a teacher appears. Think about this for a moment. It makes good sense. The idea is that the means to reach your goals have always been available, but went unnoticed until you wanted something badly enough or were at the point where you were able to recognize and utilize them—just like Dorothy in the Land of Oz. She could have returned to Kansas any time she pleased, but she just had to learn it for herself. So do we all. Persistence, diligence, and a willingness to become a student of the marketplace are prerequisites of being a successful electronic day trader. In reading this book, you are already taking the big first step.

So, if you're ready to be a day trader, roll up your sleeves, and let's go!

Bob Baird
Craig McBurney

acknowledgments

Putting together our book, trading to not only make money, but to also generate ideas to pass on to our readers, takes significant time away from other responsibilities to family, clients, and community. We would like to thank our families and friends, who have not seen as much of us as they should have, for putting up with even more absences than usual.

To help drive some of our points home, we have commissioned freelance cartoonist, Bill Frauhiger, of Fort Wayne, Indiana, as illustrator for the Brokersaurus cartoon series. We want to thank Bill for the great job he did. For over 15 years, Bill has been providing quality illustration, cartoons, comic strips, logos, and caricatures for clients nationwide. Anyone wishing to contact Bill for his services can call him at his studio at (219) 497-9600, or e-mail him at billfrog@concentric.net. You may also view his online portfolio on the World Wide Web at www.concentric.net/~billfrog/.

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introduction

Getting In on the Ground Floor

In the movie *Forrest Gump*, Forrest tells his benchmate at the bus stop that his partner, Lieutenant Dan, had invested all of their funds in a fruit company called Apple. It just so happened that this Apple was Apple Computer, and the duo's ground-floor investment had made Forrest and Lieutenant Dan multimillionaires.

In *Back to the Future, Part II*, the villain, Biff, gets hold of a sports record book, goes back in time before any of the games are played, and becomes wealthy by consistently betting on the winners, no matter how long the supposed odds. If you have the book, it's not hard to do.

Because hindsight is 20/20, it would be an easy job to fill up our book and many others simply by reciting examples of where you would have been today *if* you had simply made the right investment at the right time. But *if* is always the problem. Wouldn't it be nice, just for once, if you could get in on the ground floor of something new and cutting edge *before* it took off and everyone else was also clamoring to get in?

Well, congratulations, those aspiring to day trade today are in on just such a ground floor. Although day trading per se isn't new, what is new is that the quantum leaps in computer technology, telecommuni-

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cations, and the Internet together make it possible to bring the stock exchanges literally right into your lap (-top computer) in the privacy of your own home. That's not just new; that's revolutionary!

The Price of Ignorance

An early-1999 *Washington Post* article,* "In Bull Market, the Urge to Gamble Is Rising," started out like this:

Brenda Richardson wanted to squeeze a quick bundle out of the bull market to help put her daughter through college. So in late 1996, the Texas pharmacist plunked down her entire savings of \$10,000 to open an account at a Houston securities firm, starting a journey that would take her deep into the addictive world of day trading.

Richardson was given the secret code to a room full of men staring zombie-like at computer screens flickering with stock symbols. She sat at her assigned terminal and, without any investment experience, started buying and selling shares for herself. "I had no idea what I was doing," she said, "I sort of looked around to see what other people are doing."

What she witnessed was a form of high-tech gambling—traders darting in and out of stocks in minutes, sometimes seconds, usually selling all their shares before the day's closing bell.

Richardson said she quickly got into debt and handed over control of her account to a sweet-talking fellow trader. He moved her account to another firm where he was able, through excessive borrowing and wild buying and selling of shares, to trade more than \$35 million worth of stock in her name over three months. Richardson said she ultimately lost \$60,000. . . .

And so on. You get the picture. We have here exactly what the article said: a woman who had nary the slightest hint of what she was doing and who, moreover, was foolish enough to turn her account over to a stranger in the next chair. Duh! Although the general public stands aghast at such a horror story and runs immediately back to the loving arms of their brokers, is there any other arena of life anywhere on the face of this earth where a similar scenario would not have similarly led to disaster? Of course not!

The lesson here is simple. There just aren't any easy get-rich-quick schemes that work (except for the huckster selling them!). If it sounds too good to be true, it probably is. And we are not touting day trading as either. What we are saying is that electronic direct-access day trading is

* *Washington Post*, 2/1/99, p. 1.

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Artistry by Bill Frankiger

a great way to make a *living*, and a lucrative one at that. If it does anything at all, the *Post* article underscores one central, overriding point: that you must know what you are doing in order to profitably day trade. And that, dear reader, is exactly what our book is about. And you're reading it. Perhaps Brenda Richardson will, too. But at least *you* will have the necessary knowledge to avoid being the next Brenda Richardson.

Freedom Is the Goal

But, isn't buy-and-hold investing and isn't day trading gambling? Not at all. Buy-and-hold may be investing, but day trading is not gambling; it is market making. Market makers, as we have mentioned and will discuss in more detail later on, come to work each day and attempt to set stock prices at levels where buying and selling take place. As an electronic direct-access day trader, you are also a market maker, albeit one working out of your own home or from a trading room instead of out of a

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plush brokerage office. As with any market maker, because you have provided liquidity to the market, because you have taken on the risk associated with purchasing stock, and because you have done all of this as a result of one win-win situation after another, you are entitled to your profits. You have earned them no less honorably than anyone else engaged in any other legal pursuit.

What, then, is the bottom line for trading? Certainly, many may respond that they want to become rich. But simply being rich is meaningless in and of itself. One pursuit is paramount, and all others are secondary by comparison. We are, of course, speaking of *freedom*. Freedom, plain and simple, is the goal. Our finances combined with our own priorities determine whether freedom is ever achieved. Freedom is nothing less than the complete ability to set your own schedule and agenda.

Think about this. There are many wealthy people who are not free by any stretch of the imagination. They rise early to join the rat race and then compete fiercely all day long and well into the night. They can hardly get to sleep from all the day's activities and tomorrow's demands dancing in their heads. And when they do sleep, it is troubled and fitful, and they rise feeling more tired than when they had gone to bed. They certainly have provided "well" for their families, assuming that provision of material goods, instead of themselves, is the measure of providing well. Such folks are not free because they cannot or will not set their own agendas, for whatever reason. Their agendas control them and every aspect of their lives. One of the great industrialists in the early 1900s was once asked how much is enough. His reply? "Just a little bit more." Clearly, such a person is driven by the game itself, and the means becomes the end.

On the other hand, others who would never be considered wealthy may yet be entirely free. Those who own their own small homes and have enough investment income to enable them to spend most of their time traveling may not be wealthy, but they are certainly rich. And the missionary doctor who spends her life in a distant third-world country is definitely poor by almost any standard, yet is undoubtedly rich.

We believe that the freedom to truly prioritize worthy goals is the highest aim: when you can take the day, or even the week, off and go to the mountains or the beach on the spur of the moment; when you can be home with your family at dinnertime; when you can attend or even coach your kids' soccer games; when your cup runneth over to the extent that you can help others who are truly in need through no fault of their own. This is what day trading is all about.