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Chapter 1

All You Need to Know about Day Trading

Make money from the comfort of your home! Be your own boss! Beat the market with your own smarts! Build real wealth! Tempting, isn't it? Day trading can be a great way to make money all on your own. It's also a great way to lose a ton of money, all on your own. Are you cut out to take the risk?

Day trading is a crazy business. Traders work in front of their computer screens, reacting to blips, each of which represent real dollars. They make quick decisions, because their ability to make money depends on successfully executing a large number of trades that generate small profits. Because they close out their positions in the stocks, options, and futures contracts they own at the end of the day, some of the risks are limited. Each day is a new day, and nothing can happen overnight to disturb an existing profit position.

But those limits on risk can limit profits. After all, a lot can happen in a year, increasing the likelihood that your trade idea will work out. But in a day? You have to be patient and work fast. Some days nothing seems good to buy. Other days it feels like every trade loses money. Do you have the fortitude to face the market every morning?

REMEMBER

There are also other forces at play that can mess with your day trading abilities, namely high-frequency algorithms programmed by hedge funds and brokerage firms that have no emotions and can make trades faster than even the speediest human can.

In this chapter, we give you an overview of day trading. We cover what exactly day traders do all day, go through the advantages and disadvantages of day trading, cover some of the personality traits of successful day traders, and give you some information on your likelihood of success.

You may find that day trading takes advantage of your street smarts and clear thinking — or that the risk outweighs the potential benefits. That's okay: The more you know before you make the decision to trade, the greater the chance of being successful. If it turns out that day trading isn't right for you, you can apply strategies and techniques that day traders use to improve the performance of your investment portfolio.

It's All in a Day's Work

The definition of day trading is that day traders hold their securities for only one day. They close out their positions at the end of every day and then start all over again the next day. By contrast, *swing traders* hold securities for days and sometimes even months, whereas *investors* sometimes hold for years.

The short-term nature of day trading reduces some risks, because no chance exists of something happening overnight to cause big losses. Meanwhile, many investors have gone to bed thinking their position is in great shape, then woken up to find that the company has announced terrible earnings or that its CEO is being indicted on fraud charges.

But there's a flip side (there's always a flip side, isn't there?): The day trader's choice of securities and positions has to work out in a day, or it's gone. There's no tomorrow for any specific position. Meanwhile, the swing trader or the investor has the luxury of time, as it sometimes takes a while for a position to work out the way your research shows it should. In the long run, markets are efficient, and prices reflect all information about a security. Unfortunately, it can take a few days of short runs for this efficiency to kick in.

REMEMBER

Day traders are speculators working in zero-sum markets one day at a time. That makes the dynamics different from other types of financial activities you may have been involved in. When you take up day trading, the rules that may have helped you pick good stocks or find great mutual funds over the years will no longer apply. This is a different game with different rules.

Speculating, not hedging

Professional traders fall into two categories: speculators and hedgers. Speculators look to make a profit from price changes. Hedgers want to protect against a price change. They're making their buy and sell choices as insurance, not as a way to make a profit, so they choose positions that offset their exposure in another market. For example, a food-processing company might look to hedge against the risks of the prices of key ingredients — like corn, cooking oil, or meat — going up by buying futures contracts on those ingredients. That way, if prices do go up, the company's profits on the contracts help fund the higher prices that it has to pay to make its products. If the prices stay the same or go down, it loses only the price of the contract, which may be a fair tradeoff to the company.

The farmer raising corn, soybeans, or cattle, on the other hand, would benefit if prices went up and would suffer if they went down. To protect against a price decline, the farmer would sell futures on those commodities. Then, his futures position would make money if the price went down, offsetting the decline on his products. And if the prices went up, he'd lose money on the contracts, but that would be offset by his gain on his harvest.

REMEMBER

The commodity markets were intended to help agricultural producers manage risk and find buyers for their products. The stock and bond markets were intended to create an incentive for investors to finance companies. Speculation emerged in all of these markets almost immediately, but it was not their primary purpose.

Day traders are all speculators. They look to make money from the market as they see it now. They manage their risks by carefully allocating their money, using stop and limit orders (which close out positions as soon as predetermined price levels are reached) and close out at the end of the night. Day traders don't manage risk with offsetting positions the way a hedger does. They use other techniques to limit losses, like careful money management and stop and limit orders (all of which you can read about in Chapter 2).

Knowing that different participants have different profit and loss expectations can help a day trader navigate the turmoil of each day's trading. And that's important, because in a zero-sum market you only make money if someone else loses.

Understanding zero-sum markets

A zero-sum game has exactly as many winners as losers. No net gain exists, which makes it hard to eke out a profit. And here's the thing: Options and futures markets, which are popular with day traders, are zero-sum markets. If the person who holds an option makes a profit, then the person who *wrote* (which is option-speak for *sold*) that option loses the same amount. No net gain or net loss exists in the market as a whole.

Now, some of those buying and selling in zero-sum markets are hedgers who are content to take small losses in order to prevent big ones. Speculators may have the profit advantage in certain market conditions. But they can't count on having that advantage all the time.

So who wins and loses in a zero-sum market? Some days, it all depends on luck, but over the long run, the winners are the people who are the most disciplined. They have a trading plan, set limits and stick to them, and can trade based on the data on the screen — not based on emotions like hope, fear, and greed.

Unlike the options and futures markets, the stock market is not a zero-sum game. As long as company profits will grow, share prices will grow. Over the long run, there are more winners than losers; otherwise no one would put their retirement money into stocks. However, that doesn't mean there will be more winners than losers today. In the short run, the stock market should be treated like a zero-sum market.

If you understand how profits are divided in the markets you choose to trade, you'll have a better understanding of the risks you face as well as the risks that are being taken by the other participants. People do make money in zero-sum markets, but you don't want those winners to be making a profit off of you.

REMEMBER

Some traders make money — lots of money — doing what they like. Trading is all about risk and reward. Those traders who are rewarded risked the 80 percent washout rate. Knowing that, do you want to take the plunge? If so, read on. And if not, read on anyway, as you might get some ideas that can help you manage your other investments.

Keeping the discipline: Closing out each night

Day traders start each day fresh and finish each day with a clean slate. That reduces some of the risk, and it forces discipline. You can't keep your losers longer than a day, and you have to take your profits at the end of the day before those winning positions turn into losers.

And that discipline is important. When you're day trading, you face a market that doesn't know or care who you are, what you're doing, or what your personal or financial goals are. No kindly boss who might cut you a little slack today, no friendly coworker to help through a jam, no great client dropping you a little hint about her spending plans for the next fiscal year. Unless you have rules in place to guide your trading decisions, you will fall prey to hope, fear, doubt, and greed — the Four Horsemen of trading ruin.

So how do you start? First, you develop a business plan and a trading plan that reflect your goals and your personality. Then, you set your working days and hours and you accept that you will close out every night. Both of these steps are covered in Chapter 2. As you think about the securities that you will trade (Chapters 4 and 5) and how you might trade them (Chapters 6 and 7), you'll also want to test your trading system (Chapter 14) to see how it might work in actual trading.

In other words, you do need to prepare and have a plan. That's a basic strategy for any endeavour, whether it's running a marathon, building a new garage, or taking up day trading.

Committing to Trading as a Business

Many people are attracted to day trading because they can set their own hours and, hopefully, make money at the same time. They think they'll trade when their baby is napping, or on their lunch break, or in between games of golf and tennis. Well, if you plan on day trading for a few minutes here and there per day, then you can might as well burn your money in a fire pit instead. At least you won't have spent money on monitors and computers.

Day trading is a business, and the best traders approach it as such. Like any good entrepreneurs in any business, they have a business plan, which, in this case, will include what they will trade, how they will in invest in their business, and how they will protect their trading profits. Much of this book is about this business of trading: how to create a business plan, how to set up your office (both in Chapter 2), tax considerations (Chapter 18), and performance evaluation (Chapter 14). Day trading can be a lot of fun, but if you want that fun to last, you have to dedicate your time and your energy to the enterprise to make it work.

Trading part-time: An okay idea if done right

Can you make money trading part-time? You can, and some people do. But they still treat it like a job, not something to do in between hockey game periods. A part-time trader may commit to trading three days a week, or to closing out at noon instead of at the close of the market. A successful part-time trader still has a business plan, still sets limits, and still acts like any professional trader would, just for a smaller part of the day.

Part-time trading works best when the trader can set and maintain fixed business hours. Your brain knows when it needs to go to work and concentrate on the market, because the habit is ingrained.

The successful part-timer operates as a professional with fixed hours. Think of it this way: Bryan's wife's kindergarten teaching partner only works half days. She shows up when she's scheduled and, when she's there, she's doing as much work as any of the other educators. She commits her attention to her job when she's in the classroom; when she's not there she's teaching spin classes and is as focused on getting people into shape as she is getting children to learn. She doesn't pop into school to teach an extra lesson during a break from her spin class gig, nor does she sneak around setting up meetings with parents while she's helping people exercise. If she worked on one job while she was at the other, her work would suffer. And what parent wants their children to be taught by someone who won't dedicate themselves to the kids, even if it's just for a few hours a day?

TIP

If you want to be a part-time day trader, approach it the same way that a part-time teacher, part-time lawyer, or part-time accountant would approach work. Find hours that fit your schedule and commit to trading during them. Have a dedicated office space with high-speed Internet access and a computer that you use just for trading. If you have children at home, you may need to have child care during your trading hours. And if you have another job, set your trading hours away from your work time.

WARNING

Trading via an app during your morning commute is a really good way to lose a lot of money (not to mention your life if you try it while driving).

Trading as a hobby: A bad idea

Because of the excitement of day trading and the supposed ease of doing it, you may be thinking that it would make a great hobby. If it's a boring Saturday afternoon, you could just spend a few hours day trading in the forex market (foreign exchange), and that way you'd make more money than if you spent those few hours playing video games! Right?

Uh, no.

WARNING

Trading without a plan and without committing the time and energy to do it right is a route to losses. Professional traders are betting that there will be plenty of suckers out there, because they create the situations that allow the pros to take profits in a zero-sum market.

WARNING

The biggest mistake an amateur trader can make is to make a lot of money the first time trading. That first success was almost definitely due to luck, and that luck can turn against a trader on a dime. If you make money your first time out, take a step back and see if you can figure out why. Then test your strategy, using Chapter 14 as a guide, to see if it's a good one that you can use often.

Yes, we have two warnings in this section, and for good reason: Successful day traders commit to their business. Even then, most day traders fail in their first year. Brokerage firms, training services, and other traders have a vested interest in making trading seem like an easy activity that you can work into your life. But it's a job — a job that some people love, but a job nonetheless.

Working with a Small Number of Assets

Most day traders pick one or two markets and concentrate on those to the exclusion of all others. That way, they can learn how the markets trade, how news affects prices, and how the other participants react to new information. Also, concentrating on just one or two markets helps a trader maintain focus.

And what do day traders trade? Chapter 3 has information on all of the different markets and how they work, but here's a quick summary of the most popular assets with day traders right now:

- **Derivatives:** Futures, options, and CFDs (contracts for difference) allow traders to profit from price changes in such market indexes as the TSX/S&P Composite Index in Canada, or the Dow Jones Industrial Average in the U.S. They give traders exposure to the prices at a much lower cost than buying all of the stocks in the index individually. Of course, they tend to be more volatile than the indexes they track, because they are based on expectations.
- **Forex:** *Forex,* short for *foreign exchange,* involves trading in currencies all over the world to profit from changes in exchange rates. Forex is the largest and most liquid market, and it's open for trading all day, every day except Sunday. Traders like the huge number of opportunities. Because most price changes are small, they have to use *leverage* (borrowed money) to make a profit. The borrowings have to be repaid no matter what happens to the trade, which adds to the risk of forex. (Leverage isn't unique to forex — investors can borrow money to trade derivatives and stocks too.)

» **Common stock:** The entire business of day trading began in the stock market, and the stock market continues to be popular with day traders. They look for news on company performance and investor perception that affects stock prices, and they look to make money from those price changes. Day traders are a big factor in some industries, such as technology. The big drawback? Stock traders can get killed at tax time if they are not careful. (See Chapter 18 for more information.)

Managing your positions

A key to successful trading is knowing how much you're going to trade and when you're going to get out of your position. Sure, day traders are always going to close out at the end of the day — or they wouldn't be day traders — but they also need to cut their losses and take their profits as they occur during the day.

Traders rarely place all their money on one trade. That's a good way to lose it! Instead, they trade just some of it, keeping the rest to make other trades as new opportunities in the market present themselves. If any one trade fails, the trader still has money to place new trades. Some traders divide their money into fixed proportions, and others determine how much money to trade based on the expected risk and expected return of the security that they are trading. Careful money management helps a trader stay in the game longer, and the longer a trader stays in, the better the chance of making good money. Chapter 2 has more information on this.

To protect their funds, traders use *stop* and *limit orders*. These are placed with the brokerage firm and kick in whenever the security reaches a predetermined price level. If the security starts to fall in price more than the trader would like, *bam!* It's sold, and no more losses will occur on that trade. The trader doesn't agonize over the decision or second-guess herself. Instead, she just moves on to the next trade, putting her money to work on a trade that's likely to be better.

REMEMBER

Day traders make a lot of trades, and a lot of those trades are going to be losers. The key is to have more winners than losers. By limiting the amount of losses, the trader makes it easier for the gains to be big enough to generate more than enough money to make up for them.

Focusing your attention

Day traders are often undone by stress and emotion. It's hard, looking at screens all day, working alone, to keep a steady eye on what's happening in the market. But traders have to do that. They have to concentrate on the market and stick to their trading system, staying as calm and rational as possible.

Those who do well have support systems in place. They are able to close their positions and spend the rest of the day on other activities. They do something to get rid of their excess energy and clear their minds, such as running or yoga or meditation. They understand that their ability to maintain a clear mind when the market is open is crucial.

Traders sometimes think of the market itself, or everyone else who is trading, as the enemy. The real enemies are emotions: doubt, fear, greed, and hope. Those four feelings keep traders from concentrating on the market and sticking to their systems.

REMEMBER

One of the frustrations of trading is that some days, there will be more opportunities to trade than you have time or money to trade. Good trades are getting away from you. You simply don't have the resources to take advantage of every opportunity you see. That's why it's important to have a plan and to concentrate on what works for you.

Working with risk capital

WARNING

Pay attention to the words that follow this sentence: Do not use your grocery or your retirement money to day trade. Now read that line again.

Day traders lose money, and some lose everything that they start out with. Even savvy traders can have terrible days and lose a lot. The most responsible traders work with *risk capital,* which is money that they can afford to lose. They might start with $10,000 that they wouldn't care much about it if all disappeared. If you need to pull money from your RRSP to day trade, then first, think twice about whether day trading is for you, and second, be prepared to live more frugally in retirement.

Personality Traits of Successful Day Traders

Traders are a special breed. They can be blunt and crude, because they act fast against a market that has absolutely no consideration for them. For all their rough exterior, they maintain strict discipline about how they approach their trading day and what they do during market hours.

The discipline begins with a plan for how to start the day, including reviews of news events and trading patterns. It includes keeping track of trades made during the day, to help the trader figure out what works and why. And it depends on cutting losses as they occur, reaping all profits that appear, and refining a set of trading rules so that tomorrow will be even better. No, it's not as much fun as just jumping in and placing orders, but it's more likely to lead to success.

Not everyone can be a day trader, nor should everyone try it. In this section, we cover some of the traits that make up the best of them.

Independence

For the most part, day traders work by themselves, usually at home, alone, stuck in a room with nothing but some computer screens for company. It can be boring, and it can make it hard to concentrate. Some people can't handle it.

But, just like some people prefer working from home over the office, many traders thrive on being by themselves. They know their trading depends on them alone, not on anyone else. The trader has sole responsibility when something goes wrong, but he also gets to keep all the spoils. He can make his own decisions about what works and what doesn't, with no pesky boss or annoying corporate drone telling him what he needs to do today.

If the idea of being in charge of your own business and your own trading account is exciting, then day trading might be a good career option for you.

TIP

And what if you want to trade but don't want to be working by yourself? Consider going to work for a brokerage firm, a hedge fund, a mutual fund, or a commodities company. These businesses need traders to manage their own money, and they usually have large numbers of people working together on their trading desks to share ideas, cheer each other on, and give each other support when things go wrong. (If you do want to work at a professional investment firm, you will need some education beyond this book first, like a chartered financial analyst designation, among potentially other designations and degrees.)

REMEMBER

No matter how independent you are, your trading will benefit if you have friends and family to offer support and encouragement. That network will help you better manage the emotional aspects of trading. Besides, it's more fun to celebrate your success with someone else!

Quick-wittedness

Day trading is a game of minutes. An hour may as well be a decade when the markets are moving fast. And that means a day trader can't be deliberative or panicky. When it's time to buy or sell, it's time to buy or sell, and that's all there is to it.

Many investors prefer to spend hours doing a careful study of a security and markets before committing money. Some of these people are enormously successful. Warren Buffett, the CEO of Berkshire Hathaway, amassed $54 billion from his careful investing style. But Buffett and people like him are not traders.

Traders have to have enough trust in their system and enough experience in the markets that they can act quickly when they see a buy or sell opportunity. Many brokerage firms offer their clients demonstration accounts or backtesting services that allow traders to work with their system before committing actual dollars, helping them learn to recognize market patterns that signal potential profits.

A trader with a great system who isn't quick on the mouse button has another option: automating trades. Many brokerage firms offer software that will execute trades automatically whenever certain market conditions occur. For many traders, it's a perfect way to take the emotion out of a trading strategy. Others dislike automatic trading, because it takes some of the fun out of it. And let's face it, successful traders find the whole process to be a good time.

Decisiveness

Day traders have to move quickly, so they also have to be able to make decisions quickly. There's no waiting until tomorrow to see how the charts play out before committing capital. If the trader sees an opportunity, she has to go with it. Now.

But what if it's a bad decision? Well, of course some decisions are going to be bad. That's the risk of making any kind of an investment — and no risk, no return. Anyone playing around in the markets has to accept that.

But two good day trading practices help limit the effects of making a bad decision. The first is the use of stop and limit orders, which automatically close out losing positions. The second is closing out all positions at the end of every day, which lets traders start fresh the next day.

If you have some downside protection in place, then it's psychologically easier to go ahead and make the decisions you need to make in order to make a profit. And if you're one of those people who has a hard time making a decision, day trading probably isn't right for you.

The Difference between Trading, Investing, and Gambling

Many people equate gambling and day trading, and poorly prepared traders are basically doing the former. But really, day trading is a cousin to both investing and gambling. Day trading involves quick reactions to the markets, not a long-term consideration of all the factors that can drive an investment. It works with odds in your favor, or at least that are even, rather than with odds that are against you.

Many day traders also invest, and some came to trading after years of watching the markets as an investor. In addition, day traders have claimed that good poker skills are useful for understanding market psychology, and many day traders can point to a winning trade that was made for no particular reason at all. To help you keep straight the differences between day trading, investing, and gambling, this section explains which is which so that you can better understand what you're doing when you day trade. After all, you can increase your chances of success if you stick to the business at hand.

Investing is slow and steady

Investing is the process of putting money at risk in order to get a return. It's the raw material of capitalism. It's the way that businesses get started, roads get built, and explorations get financed. It's how our economy matches people who have more money than they need, at least during part of their lives, with people who need it in order to grow society's capabilities.

Investing is heady stuff. And it's very much focused on the long term. Good investors do a lot of research before committing their money because they know that it will take a long time to see a payoff. That's okay with them. Investors often invest in things that are out of favour, because they know that, with time, others will recognize the value and respond in kind. There are also many ways to invest, whether it's through buying a mutual fund that you hold for 20 years or purchasing stocks that you may rotate in and out of your portfolio annually. However you do it, the aim is grow your wealth over time.

TIP

One of the best investors of all time is Warren Buffett, chief executive officer of Berkshire Hathaway. His annual letters to shareholders offer great insight and are a great introduction to the work that goes into choosing and managing investments. You can read them at `www.berkshirehathaway.com/letters/letters.html`.

What's the difference between investing and saving? When you save, you take no risk. Your compensation is low; it's just enough to cover the time value of money. Generally, the return on savings equals inflation and no more. In fact, a lot of banks pay a lot less than the inflation rate, meaning that you're paying the bank to use your money.

In contrast to investing, day trading moves fast. Day traders react only to what's on the screen. There's no time to do research, and the market is always right when you're day trading. You don't have two months or two years to wait for the fundamentals to work out and the rest of Bay Street to see how smart you were. You have today. And if you can't live with that, you shouldn't be day trading.

Trading works fast

Trading is the act of buying and selling securities. All investors trade, because they need to buy and sell their investments. But to investors, trading is a rare transaction, and they get more value from finding a good opportunity and selling it at a much higher price sometime in the future. But traders are not investors.

Traders look to take advantage of short-term price discrepancies in the market. In general, they don't take a lot of risk on each trade, so they don't get a lot of return on each trade, either. Traders act quickly. They look at what the market is telling them and then respond. They know that many of their trades won't work out, but as long as they measure proper risk versus reward, they'll be okay. They don't do a lot of in-depth research on the securities they trade, but they know the normal price and volume patterns well enough that they can recognize potential profit opportunities.

Trading keeps markets efficient because it creates the short-term supply and demand that eliminates small price discrepancies. It also creates a lot of stress for traders, who must react in the here and now. Traders give up the luxury of time in exchange for a quick profit.

TECHNICAL STUFF

Speculation is related to trading in that it often involves short-term transactions. Speculators take risks, assuming a much greater return than may be expected, and a lot of what-ifs may have to be satisfied for the transaction to pay off. Many speculators hedge their risks with other securities, such as options or futures.

Gambling is nothing more than luck

A *gambler* puts up money in the hopes of a payoff if a random event occurs. The odds are always against the gambler and in favour of the house, but people like to gamble because they like to hope that, if they hit it lucky, their return will be as large as their loss is likely. It's a zero-sum game with one big winner — the house — and a whole bunch of losers.

Some gamblers believe the odds can be beaten, but they are wrong. (Certain card games are more games of skill than gambling, assuming you can find a casino that plays under standard rules. Yeah, you can count cards when playing blackjack with your friends, but doing so is a lot harder in a professionally run casino.) They get excited about the potential for a big win and get caught up in the glamour of the casino, and soon the odds go to work and drain away their stakes.

There is some evidence that day traders are gamblers. For example, in 2016, some researchers at the University of Adelaide published the paper "Day Traders in South Australia: Similarities and Differences with Traditional Gamblers." They found that almost 91 percent of the day traders in their survey were also gamblers, and that 7.6 percent of those also had a problem with gambling, significantly higher than among people who were not day traders. The authors concluded that many day traders are actually gamblers who have added the financial markets to the games that they play.

WARNING

Trading is not gambling, but traders who aren't paying attention to their strategy and its performance can cross over into gambling. They can view the blips on their computer screen as a game. They can start making trades without any regard for the risk and return characteristics. They can start believing that how they do things affects the trade. And pretty soon, they're using the securities market as a giant casino, using trading techniques that have odds as bad as any slot machine.

REMEMBER

If you lose money day trading, you won't get free drinks or comped tickets to the Celine Dion show in Vegas.

Busting Some Day Trading Myths

Much mythology exists about day trading: Day traders lose money. Day traders make money. Day traders are insane. Day traders are cold and rational. Day trading is easy. Day trading is a direct path to alcoholism and ruin.

There are plenty of day trading myths, some of which we've busted already — day trading is not investing and it's not gambling — and others we'll tackle in the following sections.

Myth #1: I can make millions

One big myth is that you can get rich by trading. Like any business, some will be wildly successful and make a mint. Others will crash and burn. Then there's everyone in between who works hard, sticks to their plan, and makes enough to live a decent middle-class life. If you're able to make money at day trading, then you'll likely fall somewhere in between riches and ruin. If you go into it purely to make millions, you'll fail. The goal, at least to start, should be to make enough so that you don't have to go into a boring 9-to-5 job. If you find that you are successful, then like any entrepreneur, you can work growth into your business plan.

Myth #2: Profits are guaranteed

While it's true that long-term investors have, over time, come out ahead (though that doesn't mean they will in the future), as we've said, many day traders can lose a lot of money and quickly. Bryan once interviewed someone who made and then lost a million dollars over the course of a few months.

You also only hear about the winners. No one is going to go on the speaking circuit for losing money; only the ones who make money say how great trading can be. In fact, the research into whether day traders make money is mixed. Some studies have said, some have said no. See the sidebar "Crunching the numbers: The data on day trading success rates" for links to a few related reports.

Myth #3: Day trading is dangerous

We're repeating ourselves a bit here, but day trading is only dangerous if you're unprepared and if you put your retirement or day-to-day money at risk. Make sure you're only using money that you can afford to lose and use tools and tech to help you minimize losses. For instance, many traders use stop and limit orders to reduce losses (which we cover later in the book). Understand the risk and rewards of trading and you'll be safe.

REMEMBER

Many day trading strategies rely on *leverage*, which is the use of borrowed money to increase potential returns. That carries the risk of the trader losing more money than is in his account. However, the brokerage firm doesn't want that to happen, so it will probably close a leveraged account that's in danger of going under. That's good, because it limits your potential loss.

Myth #4: It's easy

Some people think day trading is easy. Get in front of the computer and then buy and sell Apple and Amazon all day long. Here's the truth: Day trading has a relatively low rate of success, and it can be really stressful. It takes a lot of energy to concentrate on the markets, knowing that real money is at stake. The profit amounts on any one trade are likely to be small, which means the trader has to be persistent and keep placing trades until the end of the day.

Some traders can't handle the stress. Some get bored. Some get frustrated. And some can't believe that they can make a living doing something that they love.

A lot of other worthwhile activities are stressful too

Day trading is tough, but many day traders can't imagine doing anything else. The simple fact is that a lot of occupations are difficult ways to make a living, and yet they are right for some people. Every career has its advantages and disadvantages, and day trading is no different.

When you finish this book, you should have a good sense of whether or not day trading is right for you. If you realize it's the career you have been searching for, we hope it leaves you with good ideas for how to get set up and learn more so that you are successful.

And if you find that maybe day trading isn't right for you, we hope you get some ideas that can help you manage your long-term investments better. After all, the attention to price movements, timing, and risk that is critical to a day trader's success can help any investor improve their returns. What's not to like about that?

CRUNCHING THE NUMBERS: THE DATA ON DAY TRADING SUCCESS RATES

Academic researchers like to work with data from the financial markets because there is so much of it. They are always looking at who makes money and how they are able to do it. Here we review some of the literature to show you the current state of day trading success rates. Note that they are low. Few people who take up day trading succeed, in part because few people who take it up are prepared. And even many of the prepared traders fail.

- ***Do Individual Currency Traders Make Money?*** In 2014, Boris Abbey and John Doukas looked at the performance of 428 foreign exchange accounts from 2004 to 2009. They found that it was indeed possible for traders to do well; half of the traders studied earned positive returns even considering transaction costs, although only a quarter of the traders that they looked at had positive returns after adjusting for risk. You can see the abstract at `www.sciencedirect.com/science/article/pii/S0261560614001624`.
- ***Do Individual Day Traders Make Money? Evidence from Taiwan:*** This paper, written in 2004 by Brad Barber, Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean (and available at `http://faculty.haas.berkeley.edu/odean/papers/Day%20Traders/Day%20Trade%20040330.pdf`), found that only 20 percent of day traders in Taiwan tracked between 1995 and 1999 made money in any six-month period, after

considering transaction costs. Median profits, net of costs, were $4,200 (USD) for any six-month period, although the best traders showed semi-annual profits of $33,000. The study also found that those who placed the most trades made the most money, possibly because they were the most experienced traders in the group. This paper is one of the most cited on the subject, and the authors have found similar results looking at other time periods and in other markets.

- ***Overconfident Individual Day Traders: Evidence from the Taiwan Futures Market:*** Researchers Wei-Yu Kuo and Tse-Chun Lin looked at the results of 3,470 traders between October 2007 and September 2008 and found that most of them had significant losses after transactions costs were considered. The biggest problem seemed to be that traders over-estimated the quality of the news they received as well as their ability to evaluate it. This led to excessive trading — especially for those that ended up with the largest losses. The abstract is available at `www.sciencedirect.com/science/article/pii/S0378426613002331`.
- ***What Do Retail FX Traders Learn?*** Simon Hayley and Ian Marsh of City University in London collected data from a retail trading platform that had 95,000 individual investors over 30 months. Not all of these people were day traders, although many of them were and are. They found that traders didn't necessarily learn to trade in order to get better over time, but they did learn how to manage risk and position sizes based on their own skill and results. In addition, those who had an unsuccessful trading day were more likely to trade less, trade smaller amounts, or take a break from trading all together. They also found that even experienced traders often lose money. You can see an article about their findings at `www.cass.city.ac.uk/faculties-and-research/research/cass-knowledge/2017/november/what-do-retail-fx-traders-learn`.