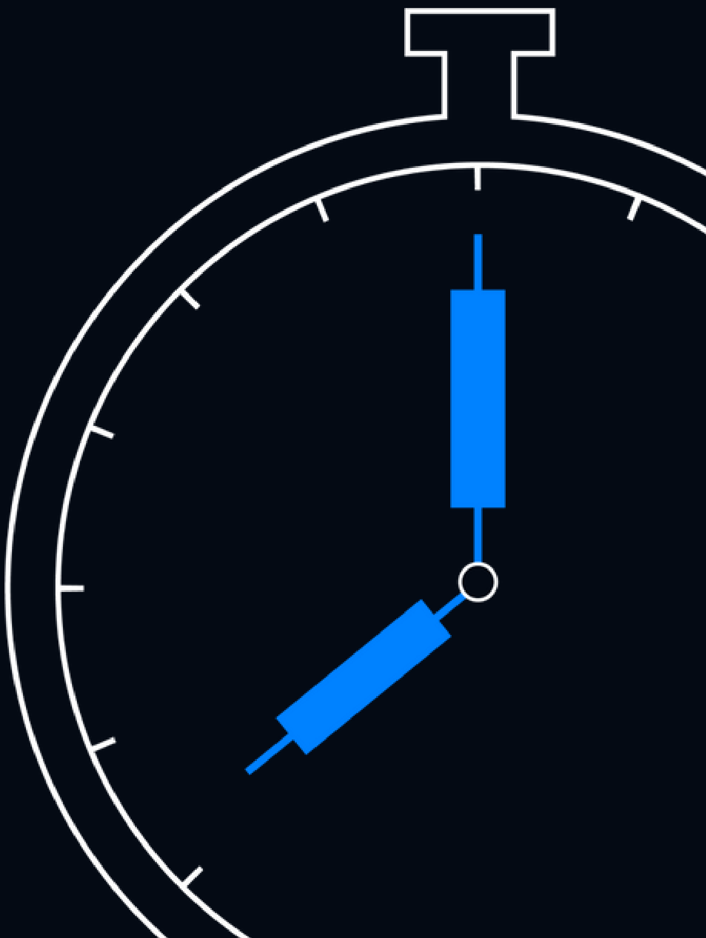
Day trading

Your fundamental guide to day trading



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THE RISE OF DAY TRADING

The instantaneous trades executed by complex algorithms are a far cry from the humble beginnings of day trading

Ticker tape may make you think of huge parades, as soldiers, politicians, or festival floats are engulfed in a flurry of torn paper gleefully cast from open windows lining city streets. But the humble ticker tape once fulfilled an important role in prompting an important shift in the narrative of trading.

In 1867, many decades before computers and the internet, the creation of the first telegraphic ticker tape machine helped traders and brokers communicate information about transactions on the New York Stock Exchange floor, while ticker tape became the catalyst for day trading. But how exactly did the newly established system encourage this way of trading?

WHAT IS DAY TRADING?

A day trader buys and sells a security looking to profit from any price changes during a single trading day. They most commonly aim to trade easy-to-sell stocks, indices, commodities, or currencies in stock exchange and foreign exchange markets – either with their own cash or borrowed.

A trader can buy stocks in anticipation of being able to sell them at a higher price at a later point. Or through short selling a trader can borrow a stock to sell, before buying it back and returning it to the original lender. In this instance, the trader is betting that the share price will drop after it is sold, so that it can be bought back at a lower price and the difference can be pocketed.

In order to anticipate price changes, no matter how big or small, traders utilise a range of technical analysis tools and charts. Traders will also carefully monitor scheduled market announcements, such as company trading updates, economic data (such as the highly-anticipated US non-farm payrolls), and interest-rate changes.

The reason for this is that they are hunting for momentum. Day traders need to see prices moving, and these types of events can often result in price movements.

Traders will use all this information to predict how markets and prices will react to such news, and which stocks might offer bigger returns. A stock that moves up and down a lot – a volatile stock – is ideal for profitable day trading. It is about making quick decisions to take advantage of those swings.

Alternative intraday strategies include the exotically named scalping, which involves making a large number of trades a day trying to profit from very small price movements, or the somewhat controversial high-frequency trading, using algorithms to make high volumes of trades rapidly, to capitalise on fluctuations caused by positions taken by large institutions.

BENEFITS AND RISKS

Typically, a trader will use online trading platforms to make their trades throughout the day, the number of which depends on their particular strategy. The trader closes their positions before the markets close, ready to implement the strategy again the next day. Day trading can be done remotely, and many traders do it from their own homes.

As day traders have no positions overnight, they are not exposed to sudden swings in prices because of an unexpected, off-diary event, like the collapse of a business, or a tweet from Elon Musk. Everything is contained within the times you are invested in the market, which helps you to stay in control of your strategy.

But day trading isn’t for everybody. You need a thorough understanding of how markets work before you begin. It also needs a huge amount of determination and mental toughness.

You should be prepared to handle your share of losing trades, and use the available risk-management features diligently, in line with your strategy or trading plan, to help minimise losses, and take profits on winning trades.

DAY TRADING SOFTWARE

Day traders need to be able to log in to an electronic communication network that allows them to access information, such as bid and ask quotes for securities, and to automatically match and execute orders. There are various applications which enable a direct connection with brokers to make immediate or automatic executions of trades. There are also other options which help you avoid paying commission to brokers.

Traders will also need to have software which can help them analyse stock or currency patterns, charting capability, and products that include news on stories that might impact on positions or strategy.

Another useful feature is portfolio-tracking software. This can be used to look at previous trades, identify mistakes, and improve strategy. Market scanning software can flag potential trading opportunities.

Back-testing software can also be used to gauge how a strategy would have fared in past market conditions, helping traders to gauge potential future moves.

Successful traders

Paul Tudor Jones

The billionaire trader and investor made his fortune shorting the 1987 stock market crash. He forecast that people would buy index puts to lower their portfolio risk, thus driving the market down even lower. On Black Monday (19 October) he reportedly tripled his capital from short positions on stocks.

Mobile trading software in the form of apps are becoming more and more popular. Trading apps are especially useful when you're on the move, and usually offering a range of features and tools, including live prices, trading alerts, charting, and order tickets.

HOW TO GET STARTED

If you are ready to start trading, you will need to consider the markets and securities you are interested in. You will also have to consider how much money you can afford to trade with – and potentially lose – and how much time you will be able to focus on the activity.

You will need to decide on a strategy – which we discuss later – and invest in the necessary software. Undertake research, and join trader social networks to exchange ideas and information.

Day traders can trade on a huge range of instruments, including stocks, indices such as the FTSE 100, commodities like gold, and much more. Currencies, or forex, can be a good starting point for beginners.

It's important to consider the volatility of an instrument, or the underlying market. While volatility heightens price movement, it also increase risk.

THE TECHNICAL BASIS OF DAY TRADING

Day trading requires the ability to understand and analyse charts – here are some of the basic techniques

There are two core analysis types that traders typically partake in. The first of these, fundamental analysis, as the name may suggest involves focusing on a company's fundamentals — revenue, earnings, assets and liabilities. A trader may look at a company's key financial metrics, and potential future returns, then assess if the current price is overvalued or undervalued as an indicator to whether it is a good investment. Ultimately, a trader can try to use this information to measure a stock's intrinsic value, as well as predict market performance.

Then there is technical analysis. Technical analysis is the evaluation of a financial asset through the study of historical market statistics, such as price movement, volume, and chart patterns, to give indications of future market direction.

Some analysts specialise in technical analysis, while others favour fundamental analysis, and some consider both. It is up to the individual trader which type they lean on more heavily, but ultimately, the information gleaned is likely to prove helpful.

In day trading, however, technical analysis is often used more, as fundamentals become less important when trading intraday price action.

Technical analysis involves analysing patterns, and spotting trends in historical trading data, such as price movements, and volume. This allows a trader to decide the best buying and selling opportunities in a chosen market, and to determine the best time to enter or exit a trade.

There are three core theories in technical analysis: everything a trader needs to know about a security can be found in its price; market prices move in trends rather than erratically; and, these trends tend to be repeated in cycles.

THE BASICS OF TECHNICAL ANALSYIS

Creating, maintaining and understanding charts is at the heart of technical analysis. You can plot the information of an instrument's past price changes on a chart to evaluate how it changes over time.

A chart can provide an indication of future price performance, allowing a trader to time their entry or exit from a given market, as well as helping to determine where best to place a stop loss.

Here are three basic technical analysis techniques you can use:

1. UNDERSTANDING CANDLESTICKS

While there are numerous charts and ways of charting a stock's performance – from simple line charts to mountain charts, to much more advanced examples such as a renko chart – one popular but highly effective way to view daily price movements is by using a candlestick chart.

A candlestick chart is composed of a series of candlesticks – symbols that show the distance between the opening and closing prices of a security, the daily range of a stock, and sentiment.

The colour of each candlestick is important, as it indicates the direction of the market. A green or white body will show that an instrument has increased from a previous period of time (a bullish candle), while a red or black body signifies that the price has decreased (a bearish candle) – see figure 1.

The base of the body of a bullish candlestick will show the opening price of a security, and the top, the closing price. The reverse is true on a bearish candle, where the top of the candlesticks body indicates the open price, and the base the closing price.

The wicks, both top and bottom, indicate the range of price movement during the day. Longer wicks can indicate rejection of a price level, as the price throughout the day has been pushed much higher or lower before settling. Important candlestick formations include a doji, a hammer, and a shooting star – see figure 2/3.

Candlesticks can be useful alongside a number of other technical analysis techniques to help a trader identify patterns and determine the short-term direction of a security's price. Using this knowledge, alongside a number of other charting techniques, can also determine the best time to enter or exit a trade.

According to a 2018 report from BrokerNotes, there are 13.9 million online traders globally.

- Asia is home to the most with 4.6 million
- 3.1 million are in Europe
- 2 million in Africa
- 1.6 million in North America

Figure 1: UNDERSTANDING CANDLESTICKS

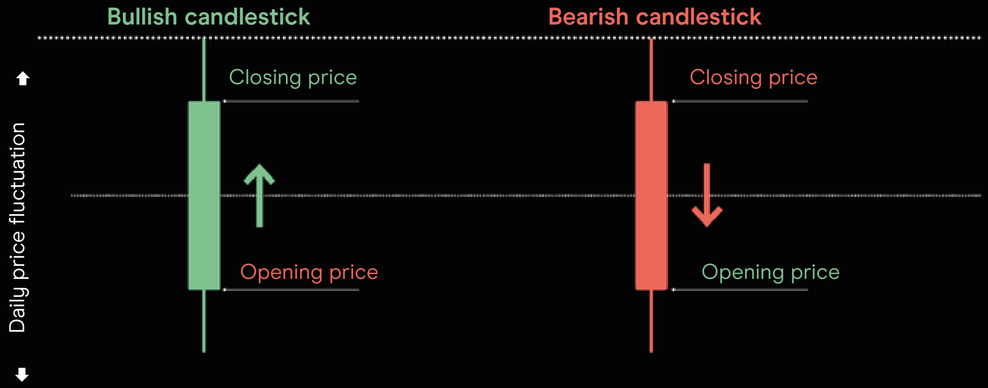


Figure 2: UNDERSTANDING DOJIS

A doji is a candlestick without a real body as the open and close prices are the same.

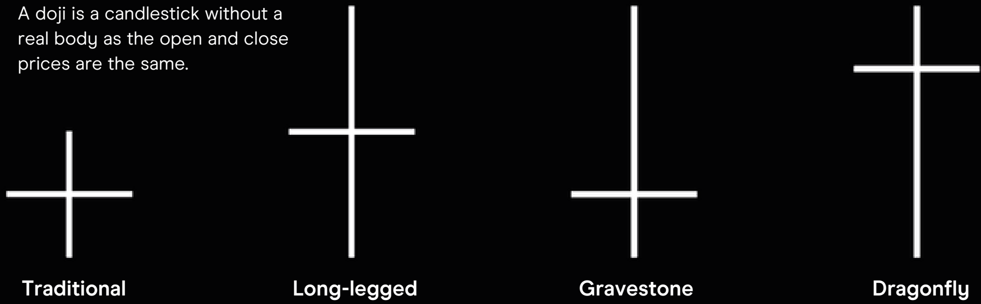
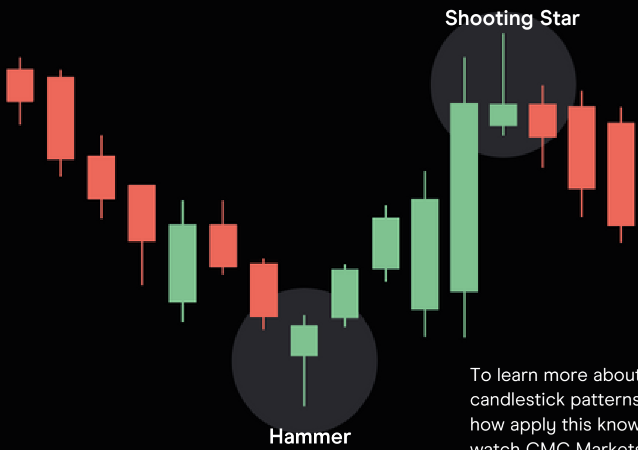


Figure 3: A HAMMER AND SHOOTING STAR

In this example of a hammer, the long wick on the hammer candle (circled left) shows where price tried to test lower levels, but strong buying came into the market. This increases the likelihood of further bullish candles (upward price movement).

The shooting star formation (circled right) is like an inverted hammer, but occurs in an uptrend. A shooting star can indicate a bearish reversal is about to happen, as price action tried but failed when testing higher levels.



To learn more about candlestick patterns, and how apply this knowledge, watch CMC Markets latest video [here].

2. CHART ANALYSIS: UPTRENDS AND DOWNTRENDS

In an uptrend, a price will reach higher highs than previously, and when the price drops again, the lows will be higher than previous lows. Conversely, in a downtrend, a price will reach lower highs than previously, while it also reaches lower lows.

Whenever there are two data points on a chart, a trend line can be drawn. This could be done by connecting one high to the next, for instance. This trend line can then be used to project where the next wave of highs or lows could happen.

The price channel is the space between two trend lines. The channel is where you will follow and analyse the price action activity. Trend lines show areas where an instrument's price could move to.

3. SPOTTING SUPPORT AND RESISTANCE LEVELS

A support level refers to the position at which the price of a security stops moving downwards, due to a concentration of buying interest overcoming selling pressure, and a downtrend reverses course. Typically these support levels form where there has been previous price action in the market – see figure 5.

A resistance level is the opposite – when the price of a security stops climbing due to selling pressure overcoming buying interest. This pushes the price of a security back down after

How candlestick patterns indicate price direction

There are numerous candlestick patterns that can be used to indicate market movements. Common patterns include:

Bearish/bullish engulfing
Engulfing patterns consist of two candles, with the body of the second extending past the first. They are used for identifying trend exhaustion and a possible reversal.

Rising/falling wedge
Wedges are multiple candlestick formations that involve extended durations. They indicate a tightening of support and resistance lines, where these lines tend to converge. They are useful for identifying the continuation of a prevailing longer-term trend, and when a price might break through a support or resistance level.

Want to learn more?

On our website, we offer a wide range of helpful articles and trading guides. If you would like to read more about different types of candlestick patterns and how to analyse them, click here.

Figure 4: PRICE CHANNELS AND BREAKOUTS

Figure 5: SUPPORT AND RESISTANCE LEVELS

These isolated trends can also give you guidance on how to time your entry into a market, or indeed your exit.

an uptrend. On a chart, support and resistance levels are highlighted with trend lines either in a horizontal or angled direction.

If a trader is able to accurately spot a support or resistance level on a chart, this can present opportunities to enter a trade. A trader could enter with a buy position at, or just above, a valid support trend line.

If a security's price decline reaches this line, the price could, in theory, increase again, leading to a profit. With resistance, a trader looking to short a stock can do so at, or just below, this trend line. As the price reaches this point, a short seller can sell as the price is likely decrease, enabling a profit on the short trade.

Without considerable practice and experience, trend lines can be misplaced or miscalculated. There is always a level of risk when using them, given that prices can, in certain circumstances, break out of a support or resistance line. This could lead to a losing trade.

In this instance, the technical characteristics of this line will be reversed – the broken resistance line would become the new support line as the price reaches new highs, while the reverse is true of a broken support line – see figure 4/5.

How to time your trade entry using trend lines:

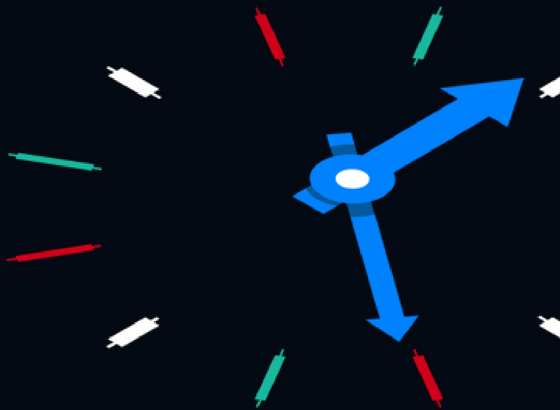
Here are two rules that can be applied to trend lines and channels when day trading:

1. Declines in price that approach an uptrend line, or price rises that approach a downtrend line, can be good opportunities to initiate positions in the same direction as the trend line.

2. The penetration of an uptrend line, particularly on a closing basis, is a sell signal, and the breakout of a downtrend line is a buy signal. Traders may apply a minimum percentage price move (1% breach on a stock for example) through the line, or a full candle close on a significant time frame, such as an hourly candle, to cement the move.

The basics underpinning a day trading strategy

Discover the psychology behind day trading and prepare yourself to 'take the bull by the horns' when trading on the live markets.



Day trading allows for a lot more freedom when trading. For the most part, you can trade when and where you want, working around your day whether you are at home, in the office, or travelling.

As a day trader, you are your own boss. You are in control. While this is one of the benefits, it also serves as a major challenge. The very fact that you have total control can be overwhelming, especially for those who struggle to create their own strategy.

To become a successful trader, you will need to understand the factors which can impact market expectations, and how they can change over time.

A wide range of factors can influence sentiment towards an instrument or market, both positively and negatively. These in turn have an impact on your positions. When day trading, you will need to stay alert to relevant news and information related to your portfolio, so you can react should your trade/s be impacted.

DAY TRADING VS LONG-TERM TRADING: WHAT IS THE DIFFERENCE?

Technically, the only difference between day trading and other forms of trading is the timeframe. Instead of holding positions for weeks, months or longer, day traders hold positions for just one day, and often close them before the market closes. Due to this shorter time period, as well as the fact that the market can move quickly in the short term, day trading strategies require more intensive focus and concentration than other trading styles.

TOP TIPS WHEN DAY TRADING

Know your state of mind

Take note of the thoughts and motivations that run through your head while you are trading. If your mind keeps wandering, it may be wise to take a break. Day trading requires constant attention and focus, which can be hard to maintain without taking a break to pause and refresh your mind.

Follow your own rules

Discipline is one of the most important qualities that experienced traders have in common. This doesn't mean that every trader should follow the same plan, but rather it is important to develop your own individual rules to match your strategy and stay committed to them.

Be aware of your bad habits

Recognise your bad habits and work to eradicate them as soon as possible. By being disciplined in setting and following your rules for your trading decisions, you can help identify and eliminate any habits which may negatively impact your ability to make sound decisions when trading. Your rules should be carefully thought out, and designed to help you trade successfully.

However, day trading is a short-term strategy, which means that your rules may not remain relevant over longer timeframes. For this reason, it is a good idea to periodically review and re-evaluate them, to ensure they are still well-matched and optimised to your strategy.

Try to find different means and methods to prevent yourself from breaking your own rules, and deal with it firmly if it becomes a problem.

Manage your money and risk

This is a crucial element in becoming a successful day trader, and will help you to minimise your risks and potential losses.

Regardless of whether you plan to trade for many years to come, or just for a few weeks or months, you need to apply a money and risk-management strategy.

There are a plethora of books, articles, and opinions offering various approaches to the topic. But it is important that you find the method and tools that work for you, and that will best support and protect your strategy.

You should also be aware of your risk-reward ratio as part of your money and risk-management method. Maintaining a risk-reward ratio of 1:2 increases your chances of remaining profitable. This means, for example, entering a trade that has the potential to generate twice your initial investment.

Remember, it doesn't matter if you win 90% of the time if your overall losses are greater than your gains. The aim is to generate more overall profits than losses.

Money and risk-management tools

When placing a market order, you can use a stop-loss order that will allow you to protect your investment. Using technical chart analysis combined with your own risk tolerance appetite, you should define the points where your stop-loss will be triggered. If you do this regularly, you can efficiently protect your trades from losses.

Note that in a period of high market volatility, a stop-loss order could be triggered, and your position might be closed before a possible upswing.

Therefore, it is important that you are aware of your stop-loss level in relation to the price action.

THE PSYCHOLOGY OF DAY TRADING

Once you have done your research and analysis, you should be ready to act quickly and decisively. As soon as your pre-calculated price levels and market conditions are met, you should place your trade. Otherwise, in such fast-moving markets, all your planning and research may be in vain.

Keep a cool head

Always try to keep your wits about you. This is especially important if you have to accept a loss. Stay calm and react according to your pre-determined set of rules. Play out the worst-case scenario in your mind beforehand, so that you are well prepared to react calmly and rationally.

Don't let other people's opinions influence your trading

Sometimes other traders want to share their views on the market and give you advice, without knowing or taking into account your trading methodology.

You know your timeframe and stop-loss strategy, and you should stick to it. Other traders may be influenced by any number of factors, including their own positions.

Stay independent
If you find yourself asking someone to back up your view, it might be a signal not to go ahead with the trade. Trust your own instincts. You have done your analysis, and plotted entry and exit levels. Believe in your numbers, and don't doubt yourself.

Be patient
Patience is essential in trading and you shouldn't trade just for the sake of it. If you don't see any opportunities that are interesting enough to you, don't force yourself to trade. Take your time in seeking out your next move, and be patient with yourself. Your intuition as a trader will improve with experience.

Manage your stress levels
Day trading can be quite stressful, given the amount of constant focus and concentration necessary to stay on top of your trades. Be aware of your own stress levels and try to counteract them by taking time out to breathe, regroup and think about your priorities, and how best to act on them.

Stay flexible
Similarly, when trading, it is important that you remain flexible with your positions. Market conditions can change quickly, and you must therefore always be ready to react to any possible changes.

Stay focused
Stick to your chosen instrument and set timeframe. These are two factors which you can control, even in a quickly-changing market environment. Keep your focus on what you can actually influence, and don't let yourself be distracted or swayed by market noise.

The fear factor
Don't be afraid to take a profit. If you close a trade with a profit and the trend continues, that's okay. After all, you are in the green and have avoided a loss.

If you continue to worry that you may have missed out on more profits after closing out, you could develop and test a re-entry technique.

As long as you are making more winning than losing trades, you should not worry too much about occasionally exiting a trade prematurely.

The importance of a trading diary

By keeping a record of your trades, and detailing why you executed each one, you can increase your learning curve and potential for success. If you take the time to do this, you can improve your trading knowledge and skillset.

Keep yourself updated on whether you are ahead or behind over a day, week, or month. If you have been day trading for a month, take the time to evaluate what you did, and what you learned during that month.

Look back at your trades and ask yourself the question, "If I could do this trade again, what would I do differently?". This can help you become a more consistent and successful trader in the long run.

CMC Markets Germany GmbH
Neue Mainzer Straße 46-50 (Garden Tower)
60311 Frankfurt am Main
Germany

+353 (0) 1 256 3000
info@cmcmarkets.ie
www.cmcmarkets.com

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