Chapter One
Lessons on Getting Ready

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Developing a Watch List

There are many different styles of trading, and different traders prepare for the market in different ways. Most traders who do more than micro scalping start off the day with some kind of watch list. This list and its preparation will vary greatly. Here are some ideas of different ways to prepare for the next day.

To prepare for the next day, you will want to look at daily charts after the market closes. If you are swing trading, you live off of the daily charts. If core trading, you live off of the daily and weekly charts. Even if you are intraday only, you will put the odds more in your favor if you have multiple time frames all going in your direction. In other words, even if you were trading intraday, would you want the stock you are playing long to be a short set up on the daily? Of course not. Start with a list of long stocks to play long, even if intraday. If you trade from a small universe of favorites, at least categorize each trend as up, down, or sideways.

The first list that is the easiest to develop is of favorite stocks that you play every day. This list may include as few as 4 or 5 stocks, or up to 30 or 40. The number does not matter: the point is that the list consists of a handful of stocks that the trader knows very well. Many traders are successful doing this. There is a big advantage because they are familiar with every stock on their list. It is likely that they all trade well, are heavy volume, and easy to get in and out of without much slippage (paying more than the strike price to get into a long position because of the bid-ask spread or small volume on the offer). There is also a big disadvantage. You will miss many strategies that day. Your small list will not often have a mortgage play, or a nice bullish gap surprise.

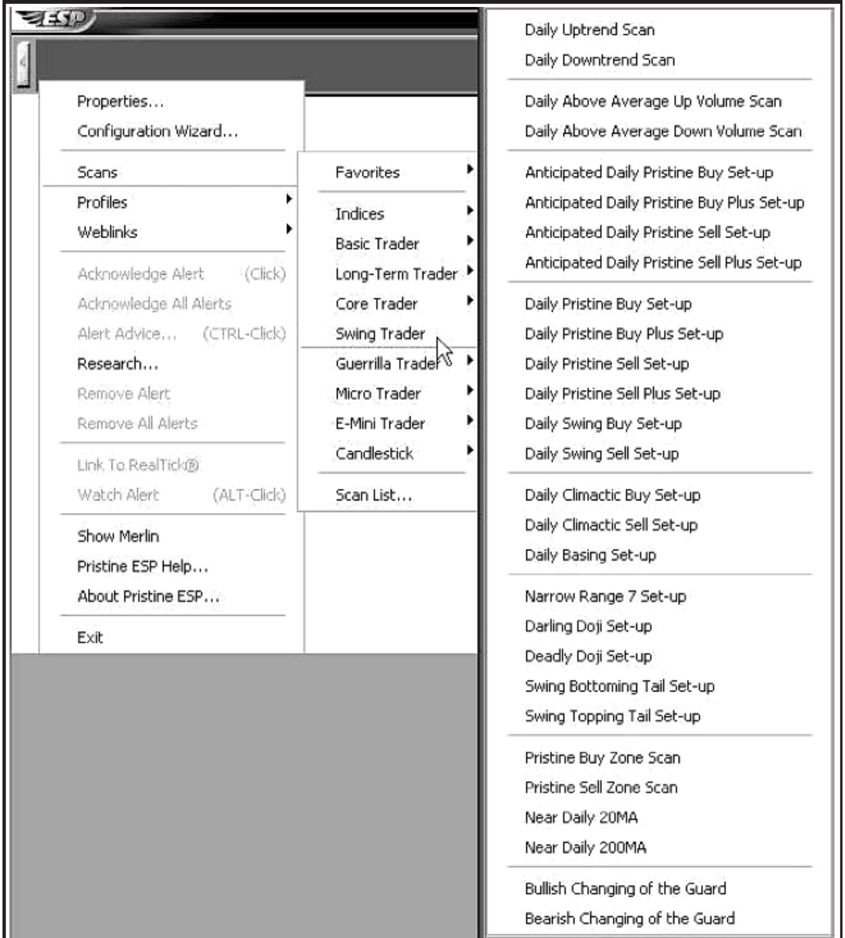
Another easy list alternative is to have someone else do most of the work for you. For example, there are Pristine chat rooms and Pristine ESP™, Pristine's real-time scanning tool, that provide end of day lists of stocks. Any of these methods simply involve you looking at the picks and following the ones that meet your trading plan requirements. This is all in addition to the scans that are far too numerous to mention here. These scans are used to find set-ups for the next day on daily and weekly charts, as well as real-time intraday scanning with alerts. Using Pristine ESP™ alone will give you more play suggestions in whatever time frame you are in than you will ever likely need. A sample of a few of the many scans in Pristine ESP™ are shown in figure 1-1. It is opened to show the swing trader scans from the daily chart.

The third type of list would be one that you generate yourself based on the patterns you want to find. It involves scanning stocks one by one until you find a pattern that matches a strategy you want to watch the next day. This method is what the rest of this lesson will focus on.

To review a list of stocks to produce a watch list for the next day, you need to have a list of stocks to review. There are about 9,000 stocks and it would not be an easy task to look at 9,000 stocks every night. So we need to have a master list of stocks that we will look at to pick our watch list. We call this our "universe of stocks." There are two different ways to create your universe of stocks.

First, you can create a universe of stocks by compiling several indices you like to follow. If you like tech, maybe you start with the NASDAQ 100 and then add the Semi Conductor Index (there will be some overlap in many

FIGURE 1-1: PRISTINE ESP



A SAMPLE SCAN

indices so your total will be less than the sum of the two indices). Maybe add the Dow, and then perhaps a few stocks you like to play, so you can add those. You may end up with 100-500 stocks in your universe.

Second, you can create a universe of stocks by starting with the entire market and then using software to scan and eliminate certain criteria. For example, if you just use two criteria such as stocks that do over one million shares a day and whose price is over $4.00, you will be down to about 400-600 total stocks, of which 200-300 will be NASDAQ stocks.

The second way, scanning, has both advantages and disadvantages. By scanning stocks to obtain your universe, you will have a different list every day. Some new stocks will join as their volume meets the requirements, some will leave as they slow up in volume. So scanning will allow you to automatically see the up and coming stocks. This is also the disadvantage because as you will have stocks entering your list that you have never seen before. Playing these often results in problems if you do not study them first.

Once you have your universe, it is simply a matter of scanning through the list every night to look for the set ups you like. Once you have some experience, you should only look at each stock for a second. If the pattern does not jump off the page at you, it is not likely to be a good one.

If you want a simple way, which takes minimal time, to manage your watch list if you are swing trading, try the following: on the weekend, review your list and look for the stocks that are defined as uptrends and downtrends. For an uptrend, look for stocks that have higher highs and higher lows, and have rising 20-and 40-period moving averages. For the best trends, look for the 20 to be above the 40 and keep a smooth, consistent distance apart. For downtrends, look for the reverse. Put these in two lists with those names. Then, every night, just look through the uptrend list for stocks that have 3-5 days down (3-5 lower highs, preferably 20-20 bars). Look through the downtrend list for 3-5 higher lows. You will then have a watch list that has the first two important components of a successful trade: a trend and a pullback.

Now that you have your list, the next lesson is about using it.

The Watch List Concept

There seems to be much confusion among new traders regarding watch lists, analyzing and entering plays. Let's review a few basic concepts.

We have already talked about how to develop a watch list. The issue now is what to do with the watch list. We put stocks on a watch list because they have formed a pattern that we recognize. They have formed a visual picture that matches a pattern we have trained our eyes to detect. This pattern is part of a strategy that we have been taught. However, the strategy has another part to it, which is when to enter the trade. The entry is almost always set to a place the stock will have a hard time crossing, or a line in the sand, so to speak.

For example, the strategy may be to play a Pristine Buy Set-up (or PBS, see Appendix A) from the daily chart over the prior day's high. The first step is to find a candidate by scanning many charts and finding a picture of a PBS that has an uptrend, a 3-5 day pullback, etc. Then, the stock goes on a watch list for the next day.

Now, here is where the problem comes in. This play should be entered long over the prior day's high. Many feel that if this is on a long watch list, it is to be played long. So, why not buy it at open and get a cheaper price? Nothing could be further from the truth. If the entry is over 32.00, let me describe how you should read the play. This stock has been falling for the last five days. It has not been able to trade over the prior day's high in five days. It has encountered selling, and that selling will likely continue. This stock is likely to fall for several more days. However, if it can trade over yesterday's high, I will play it long because it is showing the strength that may change this trend. Not just because it traded over yesterday's high, but because it did so after meeting all the criteria.

When read like that, it will stop you from thinking the wrong way. Overcoming that resistance is what makes the play work. The bigger the resistance, the stronger the stock must be to get through. It is no wonder that one trader looks at a chart and due to the resistance, sees a short. Another looks and if it breaks the resistance, sees the opportunity for a long. This is quite logical, and how you must think when you trade.

Near to this topic is the question of what plays to take. Once we meet all ten criteria for a PBS (see Appendix A), are all trades then the same? Are they all automatic buys? Do these things exist in a vacuum?

Let's say you like to fish. You have discovered an incredible lure. The lure catches fish better than anything anyone else has tried. (This is your strategy in trading talk). Now let's say you want to take your son or daughter fishing for the first time. You want to catch as many fish as possible this day. Would it matter to you if the tide was in or out? If it was 95 degrees or 40 degrees? Morning or night? From boat or shore? You may have the best lure in town, but you still look to other things to get the best fishing day. Right?

Trading is no different. Good strategies give you the set-ups and the edge you want. Many other things will improve the odds. When following a trading plan—are the futures with you or not? Did the stock gap up? Is it extended at entry? Is the risk worth the reward? Does the direction you are playing intraday match with the long-term direction? All these things involve the study of proper entries, market internals, and experience. If you track the plays you take and make it a rule to review and evaluate, it will help you pick the best plays with better consistency.

Time Frames

The subject of time frames really involves both technical and psychological discussions. Talking about the technicals of time frames is important. Many people get confused about why a stock can look short on a 5–minute chart, long on a 15, short on a daily and long on a weekly. The best entries, of course, will have as many time frames aligned as possible. I would like to step back and discuss the bigger issues of time frames.

You may recall an earlier discussion about having an income producing and a wealth account. What is the difference? Income producing refers to an account that seeks to take money out of the market every day by executing day trades and guerrilla trades. These trades are designed to be exited the same day or one day and one night. Wealth producing refers to an account that seeks to take bigger gains out of stock movements by using swing and core trading tactics. These trades may last three to five days for a swing and weeks to months for short-and long-term cores. Some may also have a separate long-term account for an IRA or college fund.

Notice that the term "investment" is missing. I believe this term to be extinct. One can no longer close his eyes on a trade and hope that it works out. All trades have an exit point. Things can change so quickly today, as technology advances, and no company is safe from competition.

It is important to keep your income producing and wealth building accounts separate. The goals of each are different. It is difficult to hold swing positions in your day trading account. In order to let profits run, you should not overmanage the position. This will likely happen if you are looking at the position all day in your day trading account.

It is also important that you use the accounts at the proper time. Day trades occur every day, so do guerrilla tactics. Most every day, some swing trades occur due to the various sectors we look at. Core trades may not occur all the time. You should enter those only at the appropriate times based on weekly charts. Setting up these accounts properly is your key to capitalizing on market moves. Let me explain this strategy.

I had previously presented a special lecture discussing core trades and looking at some possible stocks to consider for long-term core holdings. The purpose was to be prepared to enter some long core trades so you did not have to scramble if the market suddenly looked bullish. I focused only on beaten up techs that held some support area on a weekly chart. The point was to make intelligent good-odds entries.

I identified market action that led us to be bullish for the first time in a long time. I picked one core position one week, DELL, and another the next week, YHOO. There was a list of 12 stocks we discussed as possible entries at any time, but entries may depend on individual situations. There may be different needs based on the age, available cash, and so forth.

The point of the story is this: while the market had a strong move up the first week, the first day of this move is difficult to capture in a day trading account. In this market, it is not wise to hold long position day trades all day. On most days, this leads to giving back most or all of gains. This means that only partial profits are captured in a day trading (income producing) account. But, this is the purpose of the day trading account. Those who participated and took core positions or even swing positions had something working for them the whole time. There was no need to push the day trading account. It allows for clear thinking in the day trading account because you know you are already participating in the move to the wealth building account.

Using accounts properly and clearly identifying the type of trade you are entering, along with the appropriate stop and target, is key to trading.

Your Progress as a Trader

One of the most difficult things for a new trader to measure is his own progress. Many of you may feel like you are making substantial progress, but your accounts may not show it yet... This is normal.

But how do you know where you stand? Here are some observations I have made of the levels many new traders have passed on their way to becoming successful traders.

You may be someone, who has had some great successes, only to give it all back quickly. Trying desperately for those successes to return, you got frustrated and lost money. You just could not seem to find the groove you once had. You increased your share size and started keeping more overnights to get the home run to get you back to even. Eventually, your account started draining and you needed that home run more than ever. Of course, it never came.

Or you may be at the next stage. You are in a trading room. Maybe you have had a seminar or two. You see the plays. You see the strategies. You are excited because you see the trades work right in front of you. It's not like reading about someone's past conquests in a book, you are seeing the strategies in play, but you are having one of several problems. You just can't pull the trigger on a play. You might be trying, but are always just a little too late, so you either chase it to your detriment or you miss the play. Or, you seem to always pick the loser. You pick it first and then are gun shy the rest of the day. Or you might get the winner and sell it fast only to watch the room go on to hold it for a big winner. This is a common phase. You have to ask, how did some of the others get beyond this, why or how did they get in the play?

Alternatively, you may fall into another category. You are really starting to feel good. You are getting in the plays and starting to hold some winners. You are developing a real sense for getting out of the losers just in the nick of time. You are starting to grow your account. But, just then, you find a mistake comes along. It takes you back to where you were. Hmmmm, you say, you won't do that again. You don't. But, low and behold, another mistake comes along—a different one, but with the same result. However, you are getting smarter now and you keep eliminating those mistakes. If you do, you are one of the ones who make it to the next step. If not, you spend a long time in this phase trying to rid yourself of mistakes, but just can't do it. Eventually you will, but it becomes a race between getting these final touches down and making your account last.

Finally, those who make it get a feeling of calm in the morning. While you always have enjoyed trading, it is now relaxing rather than nerve racking. You look back on all those rules you learned and realized they were all that was needed. You just needed to know how to follow them. You just needed to really get it right the second time. Experience has come in and developed your sense of art for trading. Where all the technical analysis in the world tells you a stock will hold at this support level, you get a sense that it will not, so you are ready to get out quickly, and it saves you. You take a loss on a good trade in stride and take the play again the next time it comes up because it was a good play.

How long does it take to get through this process? Many time estimates have been given. I believe my experience is typical of many. My feeling of calm came over me after about 9 to 11 months of trading full time. It is hard to say; everyone is different. So what do you do to get through these steps? Well, if you are here reading this, you are already through the first step. You are getting training in a system and a discipline. It won't guarantee success, but it will almost guarantee failure if you don't get the help, or at least ensure a long learning period that takes lots of capital.

If you are in the second phase, where you just can't get involved or make the plays work for you, you need to do several things. Attend a trading seminar to learn the basics in a classroom fashion. Follow an online trading room closely and absorb what is being done. Watch for a while, paper trade, and finally trade small shares. Start with risk amounts of $50, then move to $100, $150, $250, etc., only upon successful trading at each new level of risk. Learn and build confidence without burning through cash.

Develop a trading plan and play only the stocks that fall into your plan. When you play them, make up your mind to play them. Get in first, sell in stages where you have determined to, and follow your stops. You must be able to trust yourself first. You must track your trades, using a strategy tracking spreadsheet. Eliminate mistakes; track all the data regarding your trades and follow a plan.

If you pick losing plays all the time and just can't figure out why, consider that it may not be bad luck. Perhaps you have a mindset for picking what you consider to be the safest play at a calmer time of day that is easier to enter. But consider also, maybe things are not as they seem. Is this really safer, once the market is quiet, once people are letting you buy the stock?

Think about it. You may be attracting plays that are destined to lose. Many plays that require early entries during hectic market times admittedly are anything but calming but can be among the most successful.

I always want to promote reducing risk as much as possible in trading, though some of you may be too far on the other extreme. Recognize trading has inherent risks and some of them cannot be eliminated. A famous entrepreneur once said: "Not many people will pay to see a high wire act where the tight rope is only one foot off the ground.... why? Because there is no risk, and without risk, there can be no reward...."

If you have made it to the next stage, have realized some rewards, and are doing well but just can't get the account up due to a few problems, consider this analogy taken from the great American sport of baseball. Consider a batter that hits .333 for any season can name his price in baseball. Anyone who does this year after year will be Hall of Fame material and be among the highest paid athletes on the planet. Consider that a batter who hits .250 will be sent back to the minors that year unless he has a great glove, or is a pitcher. Now consider this. The difference between .333 and .250 is one hit in three times at bat versus one hit in four times at bat. That means that for every 12 times at bat, the superstar gets one more hit than the minor leaguer. Consider how many hits often are the result of a ball passing just inches from a defender's glove, a defender who could have been playing one step out of place. Consider how many outs were the result of hitting a line drive shot that happened to be right in a defenders glove, one who never even saw the ball coming.

What is the point? Just this. Sometimes you are very close to being successful, but that 1 in 12 hit is eluding you. If you had a few bad trades, maybe you have eliminated them. Maybe you were very close to not being in those trades. You just need to fine tune, don't lose focus, and let your senses develop. *The plans and rules keep you in the game while you are learning and keep you in for the long term.*

Remember that a seminar, or any kind of instruction, no matter how excellent, is only information. The process of taking that information and translating it to a workable system demands hard work, experience, and discipline on your part. Most people do not understand this, and of those who do understand, few are actually willing to commit the hard work. Of those, even fewer have the needed discipline.

The hardest thing for me, of course, is to try to communicate all of this to you. This is not an easy profession. Many of those who learned to trade in the late 1990s are gone. Many fooled themselves. They mistook learning a difficult profession with just riding a bull market. They could be sloppy and it would not matter. It was just a matter of time before the stock came back. Many traders never even knew how to short. Why would they? The market will never go down.

Since then we have experienced a record fall, a substantial move up, and lots of sideways action. Only those who are well educated have played these moves correctly. Those learning now are getting all the tools, all the tactics, and waging battle at a time that will benefit them for the rest of their lives.