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by Michael Griffis and Lita Epstein

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Contents at a Glance

<i>Introduction</i>	1
<i>Part I: Getting Started with Trading</i>	5
Chapter 1: The Ups and Downs of Trading Stocks	7
Chapter 2: Exploring Markets and Stock Exchanges	19
Chapter 3: Going for Broke(r): Discovering Brokerage Options	31
Chapter 4: Putting Your Key Business Tool to Work: The Computer	47
<i>Part II: Reading the Fundamentals:</i>	
<i>Fundamental Analysis</i>	63
Chapter 5: Fundamentals 101: Observing Market Behavior	65
Chapter 6: Digging Into Fundamental Analysis	83
Chapter 7: Listening to Analyst Calls	103
<i>Part III: Reading the Charts: Technical Analysis</i>	117
Chapter 8: Reading the Tea Leaves: Does Technical Analysis Work?.....	119
Chapter 9: Reading Bar Charts Is Easy (Really).....	131
Chapter 10: Following Trends for Fun and Profit.....	151
Chapter 11: Calculating Indicators and Oscillators.....	167
<i>Part IV: Developing Strategies for</i>	
<i>When to Buy and Sell Stocks</i>	187
Chapter 12: Money Management Techniques:	
When to Hold 'em, When to Fold 'em	189
Chapter 13: Using Fundamental and Technical Analyses	
for Optimum Strategy	205
Chapter 14: Minimizing Trading Risks Using Exchange-Traded Funds.....	223
Chapter 15: Executing Your Trades.....	233
Chapter 16: Developing Your Own Powerful Trading System	251
<i>Part V: Risk-Taker's Paradise</i>	269
Chapter 17: The Basics of Swing Trading	271
Chapter 18: The Basics of Day Trading.....	285

Chapter 19: Doing It by Derivatives	299
Chapter 20: Going Foreign (Forex)	317
Chapter 21: Trading for Others: Obtaining Trading Licenses and Certifications	333
<i>Part VI: The Part of Tens</i>	347
Chapter 22: More Than Ten Huge Trading Mistakes.....	349
Chapter 23: Ten Trading Survival Techniques	357
<i>Index</i>	363

Table of Contents

<i>Introduction</i>	1
About This Book	2
Foolish Assumptions	2
Icons Used in This Book	3
Beyond the Book	3
Where to Go from Here	4
<i>Part 1: Getting Started with Trading</i>	5
Chapter 1: The Ups and Downs of Trading Stocks	7
Distinguishing Trading from Investing	8
Seeing Why Traders Do What They Do	8
Successful Trading Characteristics	9
Tools of the Trade	10
Taking Time to Trade More Than Just Stocks	10
Position trading	10
Short-term swing trading	11
Day trading	11
Going Long or Short	12
Managing Your Money	12
Understanding Fundamental Analysis	13
Getting a Grip on Technical Analysis	14
Putting Trading Strategy into Practice	15
Trading at Higher Risk	17
Remembering to Have Fun!	17
Chapter 2: Exploring Markets and Stock Exchanges	19
Introducing the Broad Markets	19
Stock markets	20
Futures markets	20
Bond markets	21
Options markets	22
Reviewing Stock Exchanges	22
New York Stock Exchange Euronext (NYSE)	22
NASDAQ	24
Amex (now NYSE MKT LLC)	25
Electronic communications networks (ECNs)	26

Understanding Order Types	26
Market order.....	27
Limit order.....	27
Stop order.....	28
Stop-limit order.....	29
Good-'til-canceled orders.....	30
Other order types.....	30

Chapter 3: Going for Broke(r): Discovering Brokerage Options 31

Why You Need a Broker.....	31
Exploring Types of Brokers and Brokerage Services.....	32
Full-service brokers.....	32
Discount brokers.....	34
Direct-access brokers.....	34
Proprietary trading firms.....	35
Futures brokers.....	36
Services to Consider When Choosing a Broker.....	36
Types of orders supported.....	36
Data feed.....	37
Charts.....	37
ECN access.....	38
Knowing the Types of Brokerage Accounts.....	38
Cash accounts.....	38
Margin accounts.....	38
Options.....	39
IRAs and other retirement accounts.....	39
Choosing the Right Broker for You.....	41
Considering more than price.....	41
Doing a little research.....	41
Understanding how you'll be paying.....	42
Getting to Know the Rules.....	43
Margin requirements.....	43
Settling trades.....	45
Free riding.....	45

Chapter 4: Putting Your Key Business Tool to Work: The Computer 47

Making Use of Your Computer.....	48
Identifying trading candidates.....	48
Managing your account.....	48
Improving your trades.....	49
Finding Price Charts.....	49
Checking out Internet charts with delayed prices.....	51
Considering Internet charts with real-time prices.....	51
Looking into charting software.....	52

Digging Up Fundamental Data..... 53
 Accessing Analyst Reports..... 54
 Selecting a Trading Platform..... 55
 Browser-based trading environment..... 55
 Integrated trading platforms 56
 Features to consider..... 58
 Determining Computer Requirements..... 59
 Weighing Windows versus Mac versus Linux..... 59
 Configuring your computer system..... 59
 Accessing the Internet 61
 Picking a browser 62
 Securing your computer 62

***Part II: Reading the Fundamentals:
 Fundamental Analysis 63***

Chapter 5: Fundamentals 101: Observing Market Behavior 65

The Basics of the Business Cycle..... 65
 Understanding how periods of economic growth
 and recession are determined..... 67
 Using economic indicators to determine the strength
 of the economy..... 68
 Relating bull markets and bear markets to the economy..... 69
 Employing a Sector Rotation Strategy 70
 Early recovery 71
 Full recovery..... 71
 Early recession..... 72
 Full recession 72
 Dissecting sector rotation 72
 Understanding Economic Indicators 74
 Interest rates 74
 Money supply 75
 Inflation rate 75
 Deflation 77
 Jobless claims 78
 Consumer confidence..... 79
 Business activity 79
 Using Data from Economic Indicators 81

Chapter 6: Digging Into Fundamental Analysis 83

Checking Out the Income Statement..... 84
 Revenues..... 85
 Cost of goods sold 85



- Gross margins 85
- Expenses 87
- Interest payments 87
- Tax payments 89
- Dividend payments 89
- Testing profitability 90
- Looking at Cash Flow 91
 - Operating activities 91
 - Depreciation 92
 - Financing activities 93
 - Investment activity 94
- Scouring the Balance Sheet 94
 - Analyzing assets 95
 - Looking at debt 96
 - Reviewing goodwill 97
- Determining Stock Valuations 97
 - Earnings 98
 - Earnings growth rate 98
- Figuring Your Ratios: Comparing One Company's Stock to Another 99
 - Price/earnings ratio 100
 - Price/book ratio 100
 - Return on assets 101
 - Return on equity 101

Chapter 7: Listening to Analyst Calls 103

- Getting to Know Your Analysts 104
 - Buy-side analysts: You won't see them 104
 - Sell-side analysts: Watch for conflicts 104
 - Independent analysts: Where are they? 106
- The Importance of Analysts 107
 - Tracking how a company's doing 108
 - Providing access to analyst calls 108
- Listening to Analyst Calls 110
 - Understanding the analysts' language 111
 - Developing your listening skills 112
- Locating Company Calls 114
- Identifying Trends in the Stock-Analyst Community 115

Part III: Reading the Charts: Technical Analysis..... 117

**Chapter 8: Reading the Tea Leaves:
Does Technical Analysis Work? 119**

- Understanding the Methodology 120
 - Finding everything in the price 120
 - Seeing that price movements are not always random 122

Balancing supply and demand..... 122
 Understanding where you've been..... 123
 Understanding where you're headed..... 125
 Answering the Detractors..... 125
 Walking randomly..... 126
 Trading signals known to all..... 127
 Telling Fortunes or Planning Trades..... 128
 Using StockCharts.com..... 128

Chapter 9: Reading Bar Charts Is Easy (Really)131

Creating a Price Chart..... 131
 Creating a single price bar..... 132
 Measuring volume 134
 Coloring charts..... 135
 Identifying Simple Single-Day Patterns 135
 Single-bar patterns..... 136
 Reversal patterns..... 137
 Identifying Trends and Trading Ranges..... 138
 Identifying a trading range..... 139
 Spotting a trend..... 140
 Time frame matters 141
 Searching for Transitions 142
 Support and resistance: Not just for undergarments 142
 Finding a breakout..... 143
 Sipping from a cup and saucer..... 146
 Deciding what to do with a double bottom..... 147
 An alternative double-bottom strategy..... 148
 Looking at other patterns 149

Chapter 10: Following Trends for Fun and Profit151

Identifying Trends 151
 Supporting and Resisting Trends 153
 Drawing trend lines to show support..... 154
 Surfing channels..... 155
 Trending and channeling strategies..... 156
 Seeing Gaps 157
 Common gap..... 157
 Breakout or breakaway gap..... 158
 Continuation gap..... 158
 Exhaustion gap..... 159
 Island gap..... 160
 Waving Flags and Pennants..... 160
 Withstanding Retracements..... 162
 Three-step and five-step retracements 162
 Dealing with subsequent trading ranges 163
 Dealing with Failed Signals 164
 Trapping bulls and bears..... 164
 Filling the gaps 165
 Deciding whether to reverse directions 165

Chapter 11: Calculating Indicators and Oscillators	167
The Ins and Outs of Moving Averages	168
Simple moving average	169
Exponential moving average	171
Comparing SMA and EMA	173
Interpreting and using moving averages	175
Support and resistance factors	177
Deciding the moving average time frame	177
Understanding Buy and Sell Pressure through Stochastic Oscillators	178
Calculating stochastic oscillators	178
Interpreting stochastic oscillators	179
Tracking Momentum with MACD	180
Calculating MACD	181
Using MACD	182
Revealing Relative Strength	184
Calculating relative strength	184
Putting relative strength to work	185

Part IV: Developing Strategies for When to Buy and Sell Stocks **187**

Chapter 12: Money Management Techniques: When to Hold 'em, When to Fold 'em	189
Achieving Your Trading Goals with Money Management	189
Managing Your Inventory	190
Thinking of trading as a business	191
Recognizing the trader's dilemma	191
Finding a better plan	192
Protecting Your Principal	194
Recovering from a large loss: It ain't easy	194
Setting a target price for handling losses	196
Determining good trading candidates	198
Strategies for handling profitable trades	199
Understanding Your Risks	202
Market risks	202
Investment risks	203
Trading risks	203
Chapter 13: Using Fundamental and Technical Analyses for Optimum Strategy	205
Seeing the Big Picture	206
Knowing when the Fed is your friend	206
Keeping an eye on industrial production	207

Watching sector rotation	207
Finding the dominant trend.....	211
Selecting Your Trading Stock.....	215
Trading Strategies	217
Trading the bullish transition	217
Trading in a bull market.....	217
Trading the bullish pullback	218
Trading the bearish transition.....	218
Trading in a bear market	219
Trading the bearish pullback.....	219
A hypothetical trading example.....	219

Chapter 14: Minimizing Trading Risks

Using Exchange-Traded Funds 223

What Is an ETF?.....	223
Examining the advantages	224
Avoiding the flaws.....	224
Does Family Matter?.....	225
Market-weighted ETFs.....	225
Equal-weighted ETFs	227
Fundamentally weighted ETFs	227
Sector Rotation Strategies.....	228
Early recovery	228
Full recovery.....	228
Early recession.....	229
Full recession	229
Analyzing ETFs.....	229
Portfolio Construction	230
International trading with ETFs	231
Commodities and ETFs	231
Currency trading and ETFs.....	231
Leveraged ETFs	231
Inverse ETFs	232

Chapter 15: Executing Your Trades 233

Entering and Exiting Your Trade	233
Keeping straight the bid and ask	235
Understanding the spread	235
Devising an effective order-entry strategy	236
Gaining insight through Level I, Level II, and TotalView data.....	239
Entering orders after the market closes: Be careful.....	240
Reviewing a week in the life of a trader	241
Selling Stocks Short.....	244
Avoiding Regulatory Pitfalls.....	246
Understanding trade-settlement dates	246
Avoiding free riding	247
Avoiding margin calls and forced sales	247
Avoiding pattern-day-trader restrictions.....	249
The Tax Man Cometh.....	249

Chapter 16: Developing Your Own Powerful Trading System 251

Understanding Trading Systems	252
Discretionary systems.....	252
Mechanical systems	253
Trend-following systems.....	254
Countertrend systems.....	255
Selecting System-Development Tools.....	255
Choosing system-development hardware.....	256
Selecting system-development software	256
Finding historical data for system testing.....	258
Developing and Testing Trading Systems	258
Working with trend-following systems	259
Working with breakout trading systems.....	261
Accounting for slippage.....	265
Keeping a Trading Journal.....	266
Evaluating Trading Systems for Hire.....	267

Part V: Risk-Taker's Paradise 269**Chapter 17: The Basics of Swing Trading 271**

Selecting Stocks Carefully	271
Looking at Swing-Trading Strategies.....	272
Trading trending stocks.....	273
Trading range-bound stocks.....	277
Trading volatility.....	278
Money-management issues.....	280
Using Options for Swing Trading.....	280
Getting a Grip on Swing-Trading Risks	282
Taxes (of course).....	283
Pattern-day-trading rules apply	283

Chapter 18: The Basics of Day Trading 285

What Day Trading Is All About	285
Institutional day traders (market makers).....	286
Retail day traders.....	286
Understanding Account Restrictions.....	289
The Fed's Regulation T: Margin requirements.....	289
Settlement: No free rides	290
Strategies for Successful Day Trading	291
Technical needs	291
Trading patterns	292
Scalping.....	292
Trend traders	293

Risks Are High 293
 Liquidity 294
 Slippage 294
 Trading costs 294
 Taxes (of course) 295
 Avoiding the Most Common Mistakes 296

Chapter 19: Doing It by Derivatives 299

Types of Derivatives: Futures and Options 299
 Buy now, pay later: Futures 300
 Wait and see: Options 304
 Buying Options and Futures Contracts 308
 Opening an account 309
 Calculating the price and making a buy 310
 Options for Getting Out of Options 311
 Offsetting the option 311
 Holding the option 311
 Exercising the option 312
 The Risks of Trading Options and Futures 312
 Minimizing Risks 314

Chapter 20: Going Foreign (Forex) 317

Exploring the World of Foreign Currency Exchange 318
 Types of currency traders 318
 Why currency changes in value 319
 What traders do 320
 Understanding Money Jargon 321
 Spot transactions 321
 Forward transactions 322
 Options 322
 Looking at How Money Markets Work 324
 Different countries, different rules 324
 The almighty (U.S.) dollar 325
 Organized exchanges 325
 Taking Necessary Risks in the World Money Market 326
 Understanding the types of risks 327
 Seeking risk protection 329
 Getting Ready to Trade Money 330

Chapter 21: Trading for Others: Obtaining Trading Licenses and Certifications 333

Getting to Know the FINRA Series 334
 Becoming a registered representative 334
 Becoming a registered principal 339

The ABCs of Financial Advisors.....	341
Accredited Asset Management Specialist.....	341
Chartered Financial Analyst.....	342
Certified Financial Planner.....	342
Certified Fund Specialist.....	343
Chartered Financial Consultant.....	343
Chartered Life Underwriter.....	344
Chartered Market Technician.....	344
Chartered Mutual Fund Counselor.....	344
Personal Financial Specialist.....	344
Registered Financial Consultant.....	345
The Licenses and Certifications You Need When Trading for Others.....	345

***Part VI: The Part of Tens*..... 347**

Chapter 22: More Than Ten Huge Trading Mistakes..... 349

Fishing for Bottoms.....	349
Timing the Top.....	350
Trading against the Dominant Trend.....	350
Winging It.....	351
Taking Trading Personally.....	352
Falling in Love.....	352
Using After-Hours Market Orders.....	352
Chasing a Runaway Trend.....	353
Averaging Down.....	353
Ignoring Your Stops.....	354
Diversifying Badly.....	354
Enduring Large Losses.....	354

Chapter 23: Ten Trading Survival Techniques..... 357

Build Your Trading Tool Chest.....	357
Choose and Use Your Favorite Tools Wisely.....	358
Use Both Technical and Fundamental Analyses.....	358
Count on the Averages to Make Your Moves.....	359
Develop and Manage Your Trading System.....	360
Know Your Costs.....	360
Have an Exit Strategy.....	361
Watch for Signals, Don't Anticipate Them.....	361
Buy on Strength, Sell on Weakness.....	361
Keep a Trading Journal and Review It Often.....	362

***Index*..... 363**

Introduction

Trading used to be the purview of institutional and corporate entities that had direct access to closed securities trading systems. Technical advances leveled the playing field, making securities trading much more accessible to individuals. After the stock market crash of 2000, when many people lost large sums of money because professional advisors or mutual fund managers didn't protect their portfolio principal, investors chose one of two options — getting out of the market altogether and seeking safety or finding out more about how to manage their own portfolios. Many who came back into the market ran from it again in late 2008 when the market saw its worst year since the Great Depression. In 2012, more people were coming back into the market as the Dow reached an all-time high, but will they be spooked again after the next correction?

The concept of buying and holding forever died after that 2000 stock crash; it saw some revival from 2004 to 2007 but then suffered another death in 2008. People today look for new ways to invest and trade. Although investors still practice careful portfolio balancing using a buy-and-hold strategy, they look much more critically at what they are holding and are more likely to change their holdings now than they were before the crash. Others have gotten out of the stock market completely.

Still others have moved on to the world of trading. Many kinds of traders ply their skills in the markets. The ones who like to take on the most risk and want to trade as a full-time business look to day trading. They never hold a position in a security overnight. Swing traders hold their positions a bit longer, sometimes for a few days or even a few weeks.

But we don't focus on the riskier types of trading in this book; instead, we focus on position trading, which involves executing trades in and out of positions and holding positions for a few weeks or months and maybe even a year or more, depending on trends that are evident in the economy, the marketplace, and ultimately individual stocks.

About This Book

Many people have misconceptions about trading and its risks. Most people think of the riskiest type of trading — day trading — whenever they hear the word *trader*. We're definitely not trying to show you how to day trade. Instead, we want to introduce you to the world of position trading, which is much safer, less risky, and yet a great way to build a significant portfolio.

Don't get the wrong idea; trading in securities always carries risks. You should never trade with money that you can't risk losing. That means trading with your children's education savings isn't a good idea. If you want to trade, set aside a portion of your savings that isn't earmarked for any specific use and that you believe you can put at risk without ruining your lifestyle.

Obviously, we plan to show you ways to minimize risk, but we can't promise that you won't take a loss. Even the most experienced traders, the ones who put together the best trading systems, don't have a crystal ball and periodically get hit by a market shock and accompanying loss. By using the basics of fundamental and technical analyses, we show you how to minimize your risk, how to recognize when the market is ripe for a trade, how to identify which specific sectors in the market are the right places to be, how to figure out which phases economic and market cycles are in, and how to make the best use of all that knowledge.

Within this book, some web addresses may break across two lines of text. If you're reading this book in print and want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

Foolish Assumptions

We've made a number of assumptions about your basic knowledge and stock-trading abilities. We assume that you're not completely new to the world of investing in stocks and that you're familiar with the stock market and its basic language. Although we review many key terms and phrases as we explore the basics of trading, if everything you read sounds totally new to you, you probably need to read a basic book on investing in stocks before trying to move on to the more technical world of trading.

We also assume that you know how to operate a computer and use the Internet. If you don't have high-speed access to the Internet now, be sure you have it before trying to trade. Many of the resources we recommend in this

book are available online, but you need high-speed access to be able to work with many of these valuable tools.

Icons Used in This Book

For Dummies books use little pictures, called icons, to flag certain chunks of text. Here's what they actually mean:



Watch for these little flags to get ideas on how to improve your trading skills or where to find other useful resources.



If there is something that is particularly important for you to remember, we mark it with this icon.



The trading world is wrought with many dangers and perils. A minor mistake can cost you a bunch of money, so we use this icon to point out particularly perilous areas.



When you see this icon, we're discussing higher-end, more technical material for the experienced trader.



When you see this icon, we're describing how to re-create a chart at our online partner, StockCharts.com.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with some access-anywhere goodies on the web. When you just want a quick reminder of trading basics, check out the free Cheat Sheet at www.dummies.com/cheatsheet/trading. There you'll find explanations on how to identify the beginning of bull and bear markets, how to trade in those types of markets, and how to develop your own trading system. We also recommend ten websites that offer trading information, analysis, and advice.

You can find additional information about trading in a couple of articles that supplement this book. Head to www.dummies.com/extras/trading for more information about

- ✓ Tracking important fundamental market movers
- ✓ Identifying trading chart patterns
- ✓ Applying momentum to trading decisions
- ✓ Trading on the foreign exchange market
- ✓ Checking out ten mobile apps for traders

Where to Go from Here

You're ready to enter the exciting world of trading. You can start anywhere in the book. Each of the chapters is self-contained. But if you're totally new to trading, starting with Chapter 1 is the best way to understand the basics. If you already know the basics, understand everything about the various markets and exchanges that you care to know, have a broker picked out, and have all the tools you'll need, you may want to start with fundamental analysis in Part II. Remember, though, to have fun and enjoy your trip.

Part I

Getting Started with Trading



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In this part . . .

- ✓ Know what you're getting into before you begin trading stocks by reviewing the ups and downs you'll encounter.
- ✓ Get familiar with the various stock markets and the different types of market orders.
- ✓ Pick an appropriate trading partner by finding a broker who's right for your trading style.
- ✓ Figure out the minimum hardware and software requirements and check out recommended websites and programs.

Chapter 1

The Ups and Downs of Trading Stocks

In This Chapter

- ▶ Making sense of trading
 - ▶ Exploring trading types
 - ▶ Gathering your trading tools
 - ▶ Discovering keys to success
-

Making lots of money is the obvious goal of most people who decide to enter the world of trading. How successful you become as a trader depends on how well you use the tools, gather the needed information, and interpret the data you have. You need to develop the discipline to apply all that you know about trading toward developing a winning trading strategy.

Discovering how to avoid getting caught up in the emotional aspects of trading — the highs of a win and the lows of a loss — is key to developing a profitable trading style. Trading is a business and needs to be approached with the same logic you'd apply to any other business decision. Setting goals, researching your options, planning and implementing your strategies, and assessing your success are just as important for trading as they are for any other business venture.

In this book, we help you traverse these hurdles, and at the same time, we introduce you to the world of trading. In this chapter, we give you an overview of trading and an introduction to the tools you need, the research skills you must use, and the basics of developing all this information into a successful trading strategy.

Distinguishing Trading from Investing

Trading is not the same thing as investing. Investors buy stocks and hold them for a long time — often too long, riding a stock all the way down and possibly even buying more along the way. Traders, on the other hand, hold stocks for as little as a few minutes or as long as several months, and sometimes possibly even a year or more. The specific amount of time depends on the type of trader you want to become.

Investors want to carefully balance an investment portfolio among growth stocks, value stocks, domestic stocks, and foreign stocks, along with long-, short-, and intermediate-term bonds. A well-balanced portfolio generally offers the investor a steady return of between 5 percent and 12 percent, depending on the type of investments and amount of risk he or she is willing to take.

For investors, an aggressive portfolio with a mix of 80 percent invested in stocks and 20 percent in bonds, if well balanced, can average as high as a 12 percent annual return during a 20-year period; however, in some years, the portfolio will be down, and in others, it will go through periods of high growth. The opposite, a conservative portfolio with 20 percent invested in stocks and 80 percent in bonds, is likely to provide a yield on the lower end of the spectrum, closer to 4 percent. The volatility and risk associated with the latter portfolio, however, would be considerably less. Investors who have 10 or more years before they need to use their investment money tend to put together more-aggressive portfolios, but those who need to live off the money tend to put together less-aggressive portfolios that give them regular cash flows, which is what you get from a portfolio invested mostly in bonds.



As a trader, you look for the best position for your money and then set a goal of exceeding what an investor can otherwise expect from an aggressive portfolio. During certain times within the market cycle, your best option may be to sit on the sidelines and not even be active in the market. In this book, we show you how to read the signals to decide when you need to be in the market, how to find the best sectors in which to play the market, and the best stocks within those sectors.

Seeing Why Traders Do What They Do

Improving your potential profit from stock transactions is obviously the key reason most people decide to trade. People who want to grow their portfolios rather than merely maintain them hope that the way they invest in them does better than the market averages. Regardless of whether traders invest

through mutual funds or stocks, they hope the portfolio of securities they select gives them superior returns — and they're willing to work at it.

People who decide to trade make a conscious decision to take a more active role in increasing their profit potential. Rather than just riding the market up and down, they search for opportunities to find the best times and places to be in the market based on economic conditions and market cycles.



Traders who successfully watched the technical signals before the stock crash of 2008 either shorted stocks or moved into cash positions before stocks tumbled and then carefully jumped back in as they saw opportunities for profits. Some position traders simply stayed on the sidelines, waiting for the right time to jump back in. Even though they were waiting, they also carefully researched their opportunities, selected stocks for their watch lists, and then let technical signals from the charts they kept tell them when to get in or out of a position.

Successful Trading Characteristics

To succeed at trading, you have to be hard on yourself and, more than likely, work against your natural tendencies, fighting the urge to prove yourself right and accepting the fact that you're going to make mistakes. As a trader, you must develop separate strategies for when you want to make a trade to enter a position and for when you want to make a trade and exit that position, all the while not allowing emotional considerations to affect the decisions you make on the basis of the successful trading strategy you've designed.



You want to manage your money, but in doing so, you don't have to prove whether your particular buying or selling decision was right or wrong. Setting up stop-loss points for every position you establish and adhering to them is the right course of action, even though you may later have to admit that you were wrong. Your portfolio will survive, and you can always reenter a position whenever trends indicate the time is right again.

You need to make stock trends your master, ignoring any emotional ties that you have to any stocks. Although you may, indeed, miss the lowest entry price or the highest exit price, you nevertheless will be able to sleep at night, knowing that your money is safe and your trading business is alive and well.



Traders find out how to ride a trend and when to get off the train before it jumps the tracks and heads toward monetary disaster. Enjoy the ride, but know which stop you're getting off at so you don't turn profits into losses.

Tools of the Trade

The first step you need to take in becoming a trader is gathering all the right tools so you can open and operate your business successfully. Your computer needs to meet the hardware requirements and other computer specifics we describe in Chapter 4, including processor speed, memory storage, and screen size. You may even want more than one screen, depending on your trading style. High-speed Internet access is a must; otherwise, you may as well never open up shop.

We also introduce you to the various types of software in Chapter 4, showing you what can help your trading business ride the wave to success. Traders' charting favorites such as Metastock and Trade Station are evaluated along with Internet-based charting and data-feed services. We also talk about the various trading platforms that are available and how to work with brokers.

After you have all the hardware and software in place, you need to hone your analytical skills. Many traders advocate using only technical analysis, but we show you how using both technical and fundamental analyses can help you excel as a trader.

Taking Time to Trade More Than Just Stocks

The ways traders trade are varied. Some are day traders, while others are swing traders and position traders. Although many of the tools they use are the same or similar, each variety of trader works within differing time frames to reach goals that are specific to the type of trades they're making.

Position trading

Position traders use technical analysis to find the most promising stock trends and enter and exit positions in the market based on those trends. They can hold positions for just a few days, a few months, or possibly as long as a year or more. Position trading is the type of trading that we discuss the most in this book. After introducing you to the stock markets, the types of brokers and market makers with whom you'll be dealing, and the tools you need, we discuss the basics of fundamental analysis and technical analysis to help you become a better position trader.

Short-term swing trading

Swing traders work within much shorter time frames than position traders, rarely holding stocks for more than a few days and looking for sharp moves that technical analysis uncovers. Even though we don't show you the specifics of how to become a swing trader, we nevertheless discuss the basics of swing trading and its strategies in Chapter 17. You can also read about the basics of technical analysis and money-management strategies, both of which are useful topics to check out if you plan to become a swing trader. However, you definitely need to seek additional training before deciding to pursue this style of trading — reading *Swing Trading For Dummies* by Omar Bassal (Wiley) would be a good start.

Day trading

Day traders never leave their money in stocks overnight. They always cash out. They can trade into and out of a stock position in a matter of hours, minutes, or even seconds. Many outsiders watch day traders in action and describe it as more like playing a video game than trading stocks. We discuss this high-risk type of trading in Chapter 18, but we won't be showing you the specifics of how to do it. If day trading is your goal, this book will only take you part of the way there. You'll discover the basics of technical analysis, but you need to seek out additional training before engaging in this risky trading style — check out *Day Trading For Dummies* by Ann C. Logue (Wiley).

Weathering a changing market

Housing stocks crumbled in the housing crunch. Financials were crushed in the credit crisis.

We can't claim any special foresight or knowledge to know when a stock is about to take a big plunge or a company is going to be taken over by the Fed. We don't have a crystal ball. But we were able to keep most of our money safe from the ravages of the down market since 2008. By using strategies that we discuss throughout this book, we can exit positions before giving back most of our accumulated profits — while many others unfortunately do just that.

An impending pullback is not illuminated with flashing beacons. There is no instant indicator telling us that it is time to sell everything. Instead, we close individual positions as each stock's

technical conditions deteriorate. The tools we describe in this book enable us to recognize when risk levels have changed, when few stocks are attractive, and when simply leaving most of our trading capital in cash is the best course of action.

Tight credit was still a major problem in 2012, but it is easing. Yet stock prices climbed in late 2012 and early 2013. Many traders and analysts expect another correction. We will weather this market with the majority of our trading capital intact as we take profits. Then we may make a little money by shorting a few stocks or buying some short or double-short exchange-traded funds. Thanks to the tools we show you in this book, we will be ready to trade aggressively when the technical condition of stocks begins improving again.

Going Long or Short

Before you start trading, you absolutely have to know what stocks you want to buy and hold for a while, which is called *going long*, or holding a long stock position. You likewise have to know at what point holding that stock is no longer worthwhile. Similarly, you need to know at what price you want to *enter* or trade into a position and at what price you want to *exit* or trade out of a position. You may be surprised to find out that you can even profit by selling a stock without ever owning it, in a process called *shorting*. We discuss these vital trading strategies in Chapter 13.

You can even make money buying and selling options on stocks to simulate long or short stock positions. Buying an option known as a *call* enables you to simulate a long stock position, in much the same way that buying an option known as a *put* enables you to simulate a short stock position. You make money on calls when the option-related stock rises in price, and you make money on a put when the option-related stock falls in price.

When placing orders for puts and calls, you're never guaranteed to make money, even when you're right about the direction a stock will take. The values of options are affected by how volatile stock prices are in relationship to the overall direction (up or down) in which they are headed. We discuss options and how they work in greater detail in Chapter 19.

Managing Your Money

Managing your trades so you don't lose a bunch of money is critical. Although we can't guarantee that you'll never lose money, we can provide you with useful strategies for minimizing your losses and getting out before your stock portfolio takes a huge hit. The key is knowing when to hold 'em and when to fold 'em, and we cover that in great detail in Chapter 12.



One thing that we can't emphasize enough is that you must think of your trading as a business and the stocks that you hold as its inventory. You can't allow yourself to fall in love with and thereby hang on to a stock out of loyalty. You'll find it especially hard to admit you've made a mistake; nevertheless, you have to bite the bullet and exit the position before you take a huge hit. You'll discover that housecleaning and developing successful strategies for keeping your inventory current are important parts of managing a trading portfolio.

Setting a target price for exiting a position before ever trading into it is the best way to protect your business from major losses. Stick with those predetermined exit prices and you'll avoid a major pitfall that many traders face —