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Trading For Dummies®

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- Grasp the latest on global markets
- Use both technical and fundamental analyses to optimize your investing

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Contents at a Glance

Table of Contents

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.

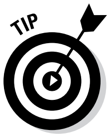
Foolish Assumptions

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:

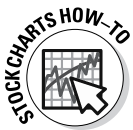


Watch for these little flags to get ideas on how to improve your trading skills or where to find other useful resources.

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

Visit www.dummies.com for free access to great Dummies content online.

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 —