Trading 101:
Foundation Course

with Matt Grossman

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Introduction

- Matt Grossman, Equity Strategist with T3Live
- Professional trader for 14 years
- Hybrid technical/fundamental approach, skewed towards technicals
- Has appeared as guest on CNBC and Fox Business and been quoted in The Wall Street Journal

What is a Stock?

Objectives

1. Answer the question: What is a share of stock?
2. Explain the process of "going public," which allows us to buy stock in a company
3. Explain why it's beneficial for companies to "go public"
4. Break down the key information to consider when analyzing a stock
5. Learn how stocks are categorized

What is a Stock?

- Stocks, also referred to as *equities*, are ownership shares in a company
- Every stockholder, no matter how big or small, is entitled to certain rights – like sharing in a company's earnings
- However, very few shareholders own a large enough stake in a company to play a major role in the company's decision-making

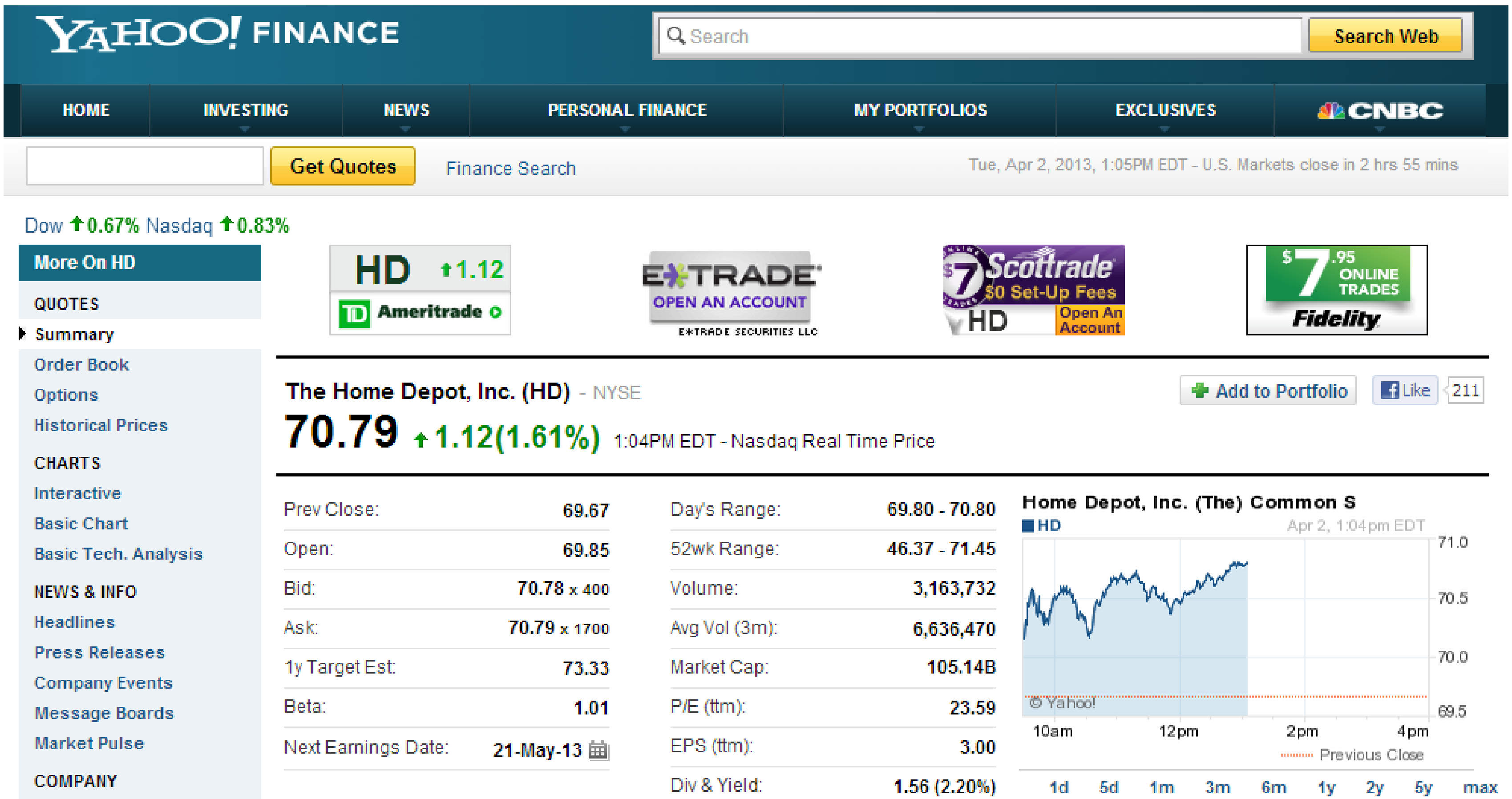
How Does a Company Get Its Shares Listed on a Stock Exchange?

- After a private company meets certain requirements, it can apply to “go public” on a stock exchange
- A publicly traded company is one that sells its shares to the public
- The sale of stock by a company to the public is called an Initial Public Offering (IPO)
- After an IPO, companies are referred to as “listed” on a stock exchange

Why Is It Beneficial for a Company To Go Public?

- Generate Capital
  - Small companies often don't have enough money to grow. Selling shares to the public raises capital needed to fund capital expenditures, research & development, and pay off existing debt
- Publicity
  - An IPO generates publicity and public awareness, which can lead to new customers
- Exit Strategy
  - An IPO can be a way for the company's owners and early investors to "cash out" of some, or all, of their investment. When a company is private it is hard to sell a stake

Yahoo! Finance



1-year Target Estimate

- The 1-year target price estimate (1y Target Est) represents the median target price as forecast by financial analysts covering the stock

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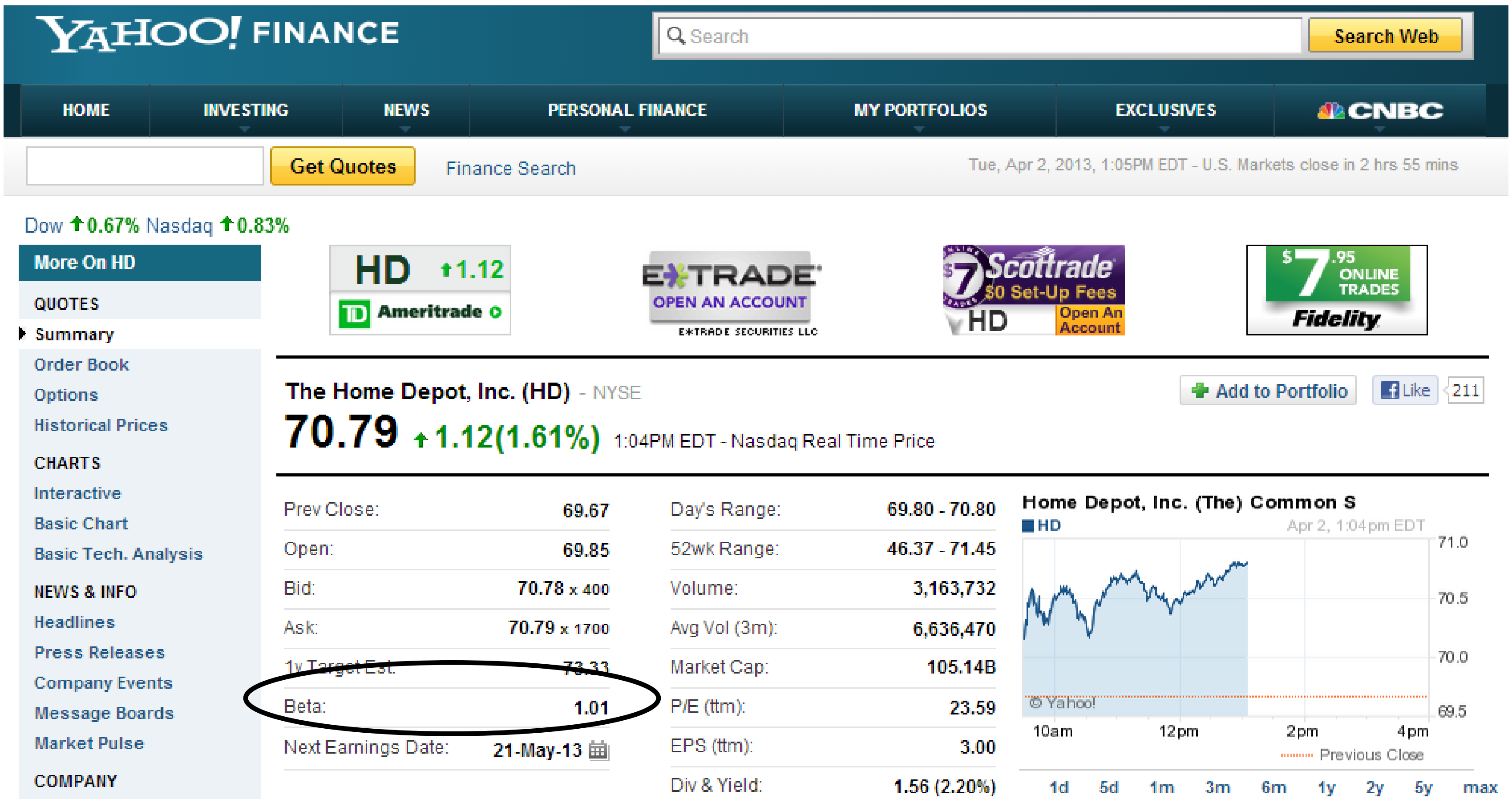

Beta β

- A calculation used to quantify volatility relative to the S&P over a 5-year period
- A stock with a beta of 1.0 is perfectly correlated to the market (i.e. the stock moves 5%, on average, every time the S&P moves 5%)
- A stock with a beta less than 1.0 is less volatile than the S&P (usually defensive sectors like utilities)
- A stock with a beta greater than 1.0 is more volatile than the S&P (usually high-growth companies)

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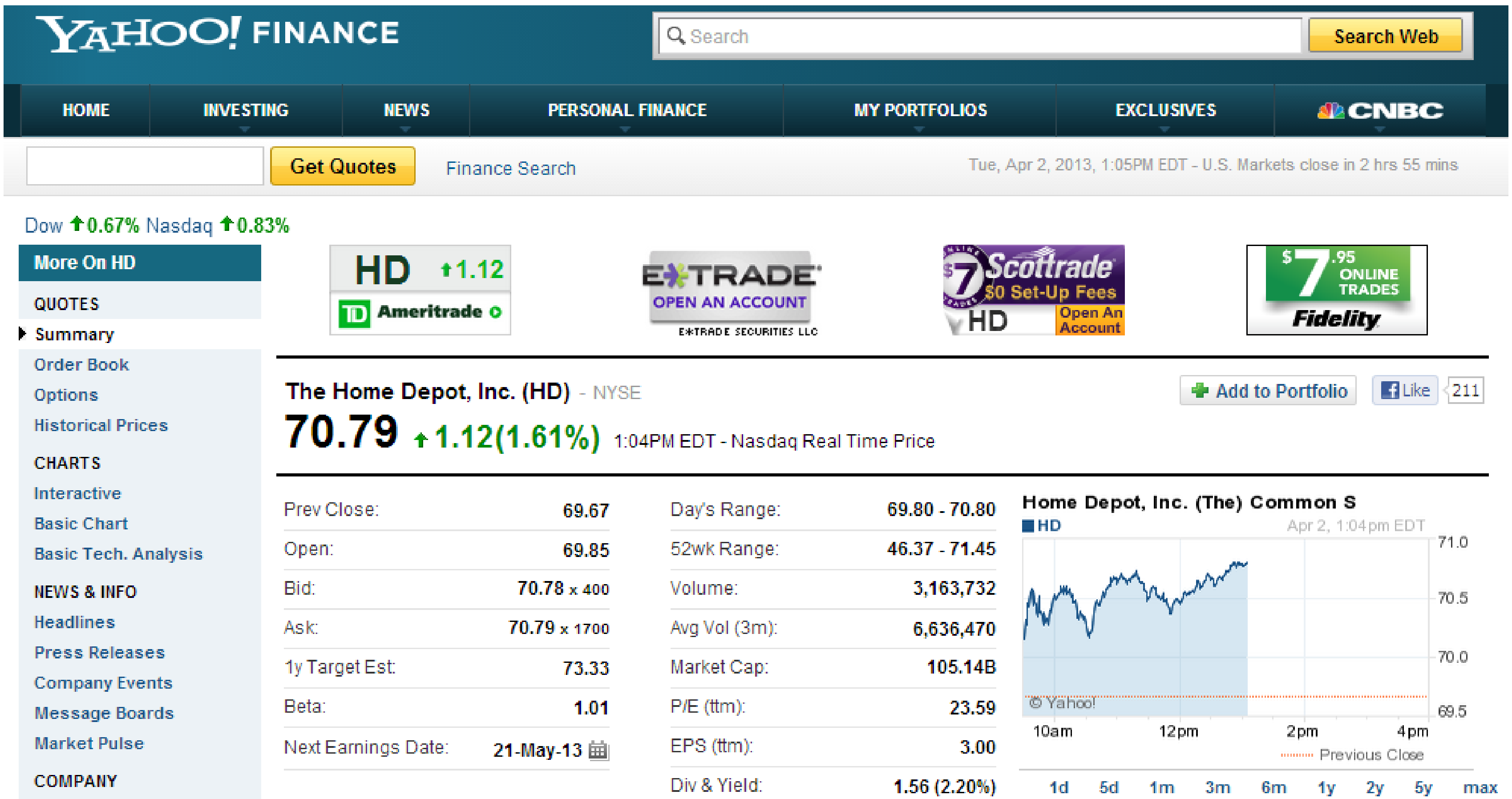

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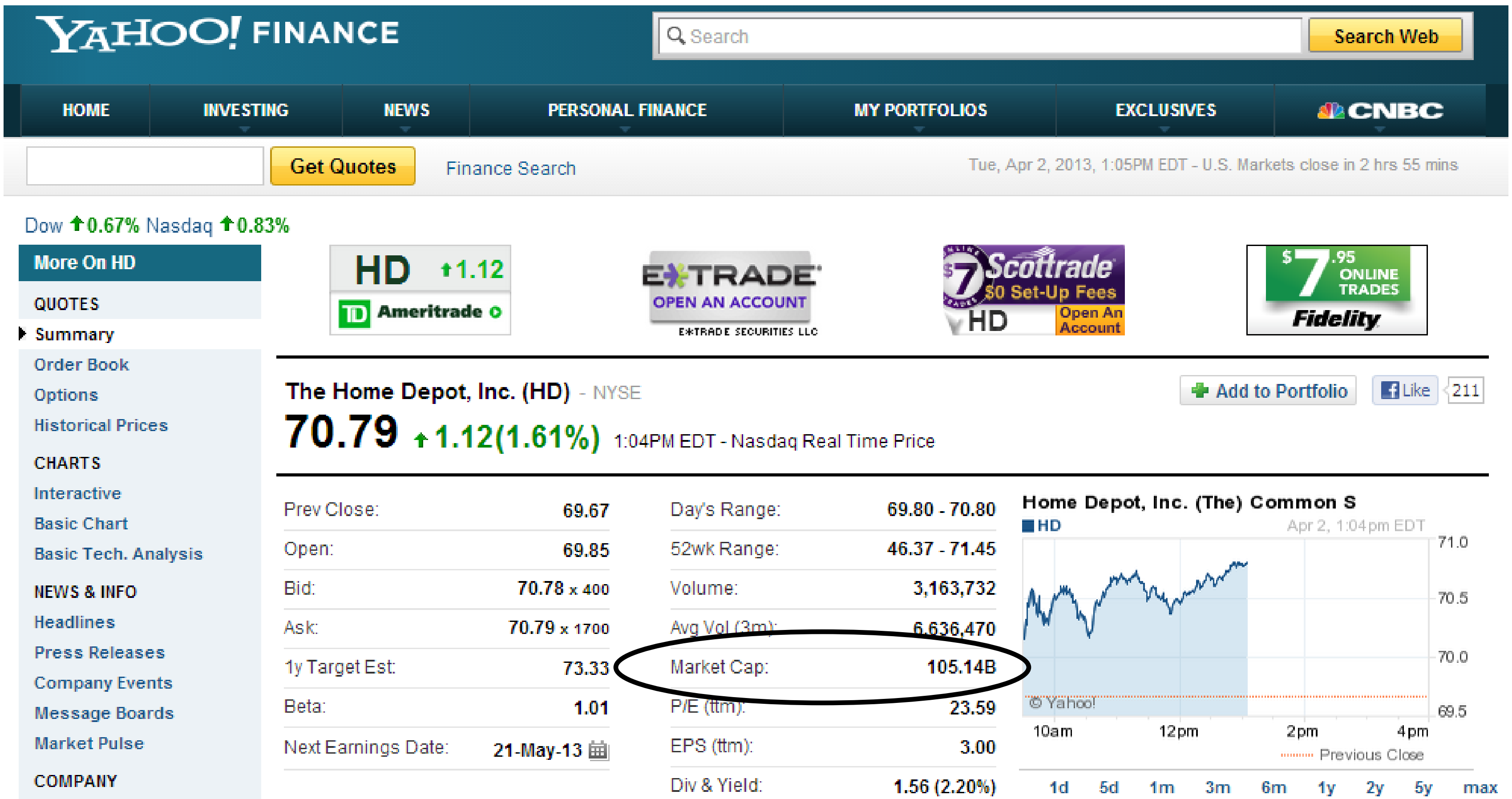
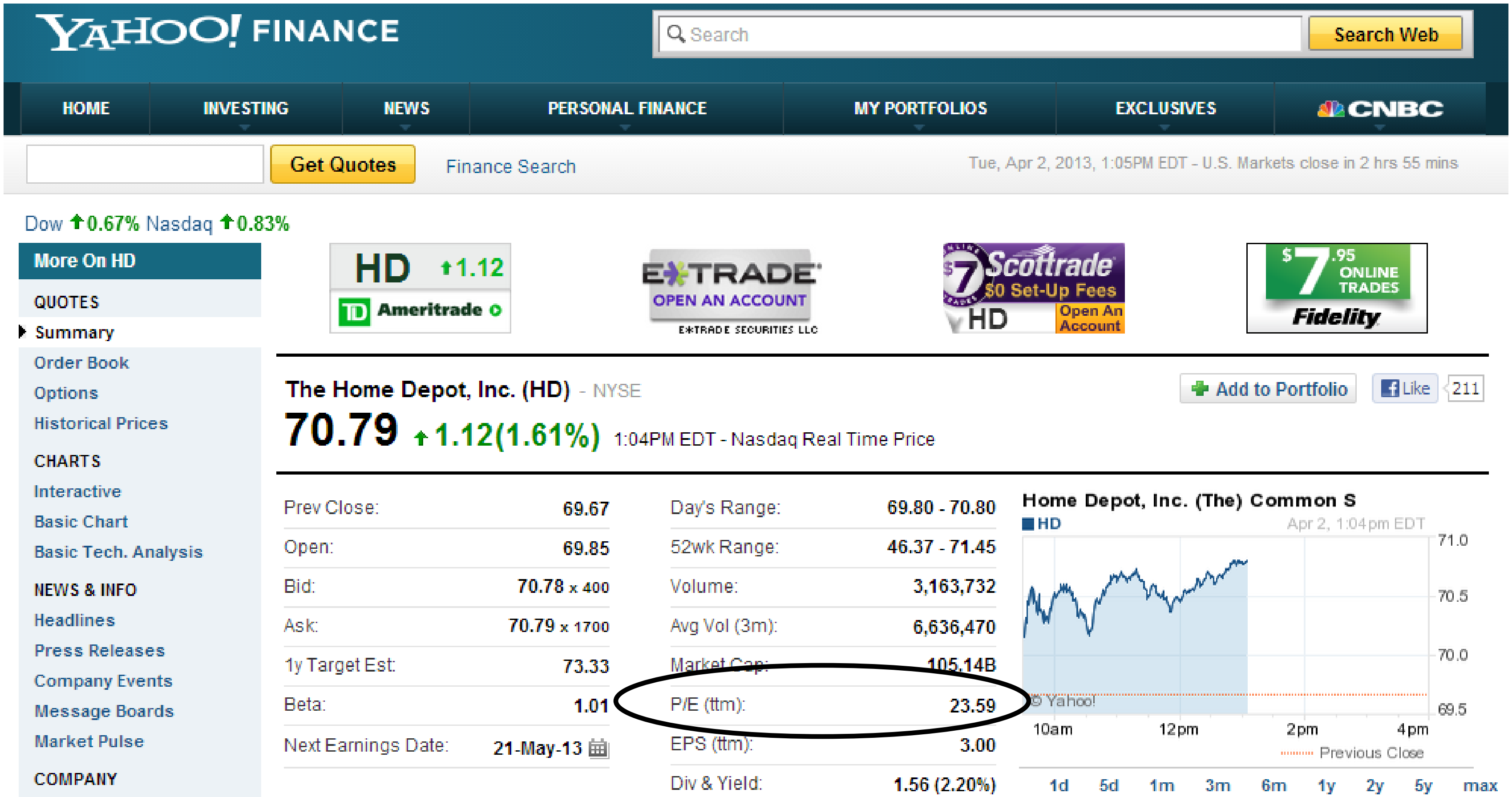


Market Capitalization

- Total dollar market value of a company
- Calculated by multiplying the share price by the total number of outstanding shares
- Commonly referred to as “Market Cap”

- Example: As of June 12, 2013, Home Depot (HD) has 1.46 billion shares outstanding, and trades at a price of $78.28, so the company’s Market Cap is $114.29 billion

Yahoo! Finance



Price/Earnings Ratio (P/E Ratio)

- A commonly used measure of a company's "value" based on its share price and earnings-per-share, or EPS
- P/E ratio is most valuable in comparing companies in the same sector

$$\text{P/E} = \frac{\text{Share Price}}{\text{EPS (trailing 12 months)}}$$

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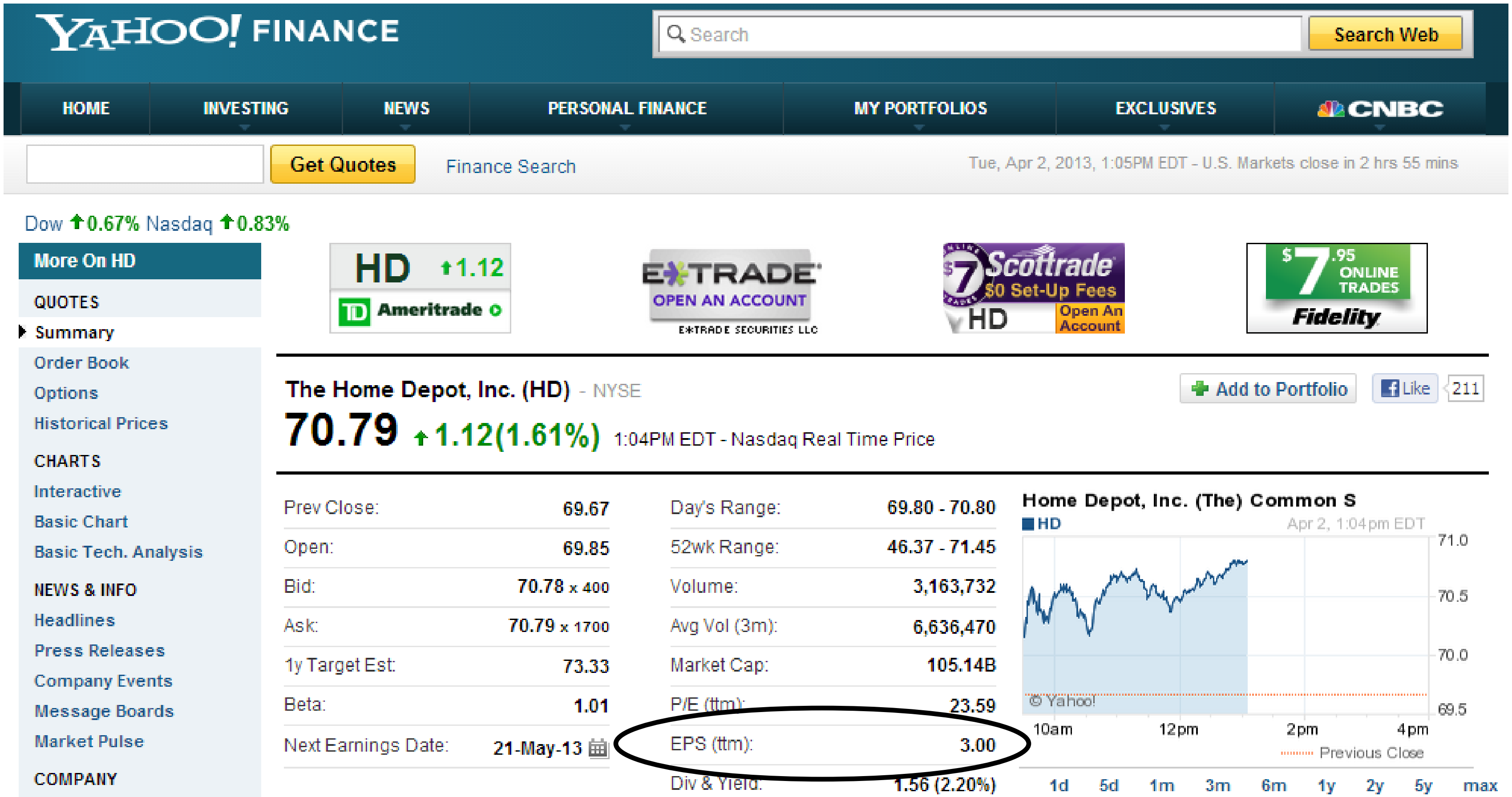

Earnings-Per-Share (EPS)

- Amount of money a company makes per outstanding share of stock
- Most commonly used measure of a company's profitability

$$\text{EPS} = \frac{\text{Net Income}}{\text{Average Outstanding Shares}}$$

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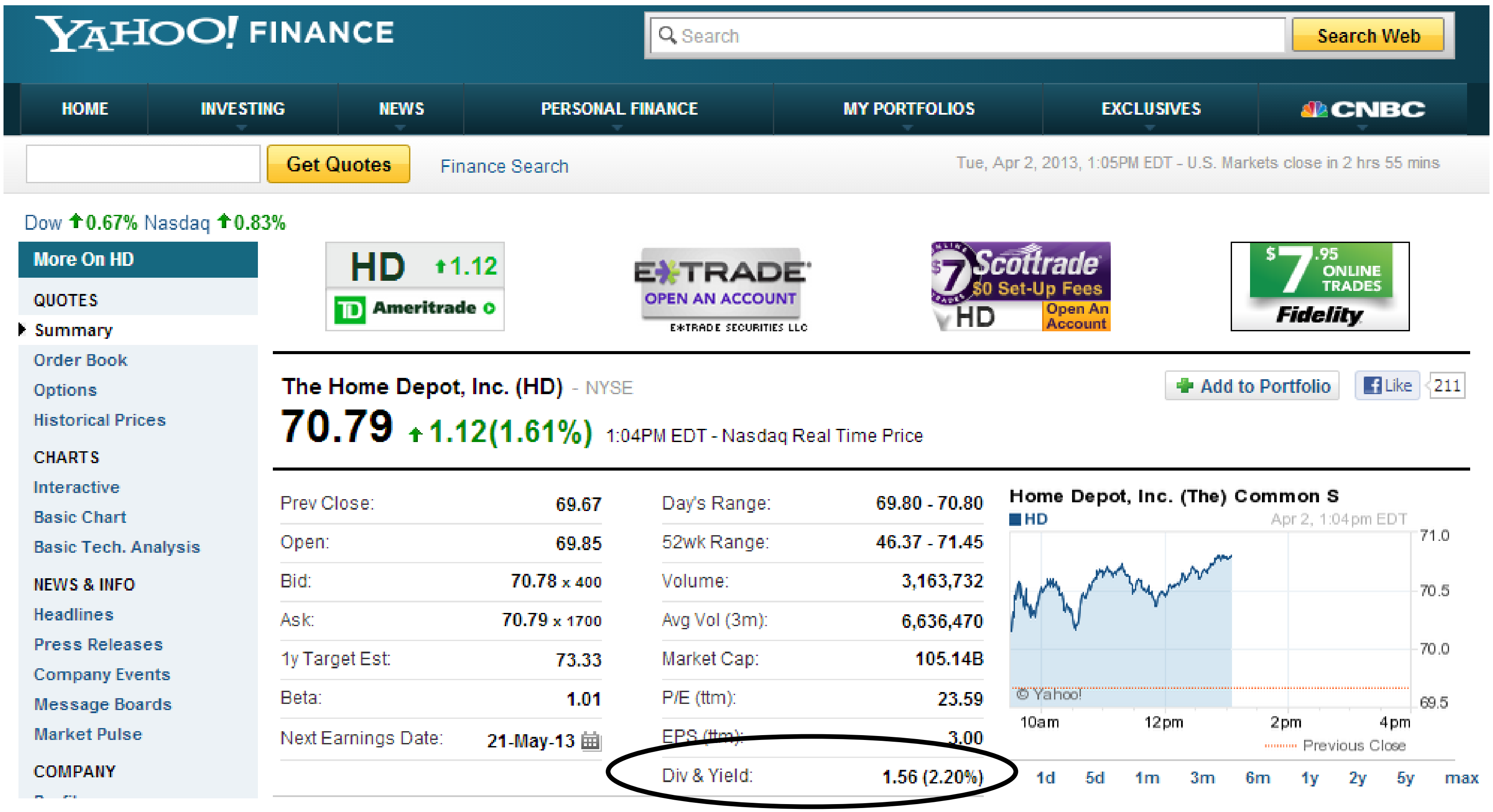


Dividends & Yield

- A dividend is a distribution of a portion of a company's earnings to shareholders
- Dividends are generally issued by low-growth companies (higher-growth companies re-invest most earnings)
- Dividend *yield* is the calculation of the percentage of the current price that is paid out as a dividend

$$\text{Div Yield} = \frac{\text{Annual Dividends Per Share}}{\text{Price Per Share}}$$

Market Cap - Explained

- Companies are typically categorized as:
  - Mega-cap: Over $200 billion
    - Ex. AAPL, XOM, WMT
  - Large-cap: Over $10 billion
    - Often referred to as “blue chips” well-established reputations and long record of financial stability
  - Mid-cap: $2 billion-$10 billion
  - Small-cap: Between $250 million-$2 billion
    - Small-cap stocks are considered riskier, but also carry greater reward potential due to fast growth

Sectors

- Companies are grouped into **sectors** based on their line of business. The nine sectors are:
  - Basic Materials (ex. Exxon-Mobil)
  - Conglomerates (ex. 3-M)
  - Consumer Goods (ex. Proctor & Gamble)
  - Financials (ex. Goldman Sachs)
  - Healthcare (ex. Johnson & Johnson)
  - Industrial Goods (ex. General Electric)
  - Services (ex. Wal-mart)
  - Technology (ex. Apple)
  - Utilities (ex. Duke Energy)

Cyclical

- Cyclical stocks tend to move in the same cycles as the overall economy
- Growing in good economic times and contracting during recessions
- Examples:
  - Car manufacturers
  - Airlines
  - Retail stores
  - Hotels and restaurants

Countercyclical

- Countercyclical stocks can perform well even in slower economies
- Countercyclical stocks are often necessities with inelastic demand
- Examples:
  - Groceries
  - Utilities
  - Alcohol and cigarettes

Growth Companies

- Companies that are growing their earnings at an above average rate (higher P/E ratio)
- Higher potential reward if you get in early in the growth cycle, but also higher risk if growth slows
- Growth stocks generally do not issue dividends, instead re-investing most earnings

Value Companies

- Companies that are past their growth stage and grow at a below-average rate (lower P/E ratio)
- Lower potential reward from price appreciation, but often considered safer and lower risk
- Value stocks generally issue dividends, returning a large portion of the company's income to shareholders

Stock Market Index

- A stock market index is a compilation of stocks constructed to track a particular market, sector, commodity, currency, bond or other asset
- Indices are computed by taking prices of selected stocks
- Used to get a snapshot of overall stock market performance
- There are three main US stock market indices:
  - Dow Jones Industrial Average (Dow)
  - Standard & Poor’s 500 (S&P 500)
  - NASDAQ Composite (Nasdaq)

Index Weighting

- Each index is tracked based on how each component is weighted. There are two ways indices are weighted:

1. Price-Weighted Index
    1. Value of the index is simply the sum of the price of each stock, so higher-priced stocks have a greater influence
    2. Ex. Dow Jones Industrial Average
2. Market Capitalization-Weighted Index
    1. Individual components are weighted according to their market cap, so that larger companies carry a larger weighting
    2. Ex. NASDAQ composite

Dow Jones Industrial Average

- The most followed US index from a retail perspective
- Comprised of 30 of the largest, most prestigious and most stable publicly traded US companies
- “Industrial” part of name is largely historical, few companies in index still involved in “heavy industry”
- Founded in 1896 by Charles Dow and statistician Edward Jones

Standard & Poor's 500 (S&P 500)

- Made up of 500 of the top publicly traded companies in the US, usually mid-cap or large-cap
- Due to the breadth of the index compared to the Dow, it gives a larger snapshot of the market and economy
- First introduced in 1923 with 90 stocks, began in present form in 1957
- Due to its breadth, often followed most closely by Active Traders

NASDAQ Composite

- Made up of all the components of the NASDAQ exchange, meaning it has over 3,000 stocks, mostly in the technology sector
- Also includes companies incorporated outside of the US and does not include financial companies
- Followed as a performance indicator of high-growth stocks, most often in the tech sector

Long vs. Short

Long vs. Short

- As a trader, you try to predict the direction (up or down) a stock is heading
- Long
  - Buying and owning a stock
  - Trader makes money when the price of the stock rises
- Short
  - Opposite of being “long”
  - Trader makes money when the price of the stock goes down

Shorting

- When a trader “gets short,” he/she is technically “borrowing” shares from another party and selling them on the open market
- The trader’s intention is to eventually buy the stock back and return it to the original owner
- If the price at which you buy the stock back, or the *buy-to-cover price*, is less than the price at which you sold the stock, then you have profited. If the price is higher, then you lost on the trade

Shorting and Risk

- Unlike with long trading/investing where your losses are limited to the amount of capital you invest (if you invest $100 you cannot lose more than $100), when shorting stock you can have theoretically unlimited losses
- Short sales are only allowed in margin accounts
  - The broker lends you the stock to sell short and then charges you interest on the margin balance
- As long as it’s part of a trading plan with rules in place, shorting can potentially improve your investment returns

Shorting Example

- Shorting might seem complicated, but it’s not
- Ex. You believe that the stock price of company XYZ is grossly overvalued at $20 and will decrease in value
- In order to profit on this idea, you go to your online broker who owns shares in XYZ and ask to borrow 100 shares with the promise you will return it to them at some point in the future
- Your broker consents, so you sell the stock at $20, creating a $2,000 short position (100 shares x $20/share)

Shorting Example

(cont.)

- Two weeks later the stock tanks as you predicted, falling to $10 per share
- At that point you buy back the 100 shares at $10 for a total cost of $1,000 (100 shares x $10/share)
- You return those 100 shares to your broker
- You have just profited $1,000 from shorting 100 shares of XYZ at $20 and *covering* them at $10

Technical Analysis

Objectives

1. Answer the question: What is Technical Analysis?
2. Learn how technical analysis is different than fundamental analysis
3. Learn different types of stock charts
4. Learn different patterns often used by Technical Analysts

Technical Analysis

- Technical Analysis is the forecasting of future prices of stocks and markets by analyzing past trading action
- Whereas fundamental analysts are concerned with *why* a stock *should* go up or down, technical analysts focus on *what* the price of the stock *is actually* doing now and where it has traded in the past
- Both technical and fundamental analysts use charts and prices to analyze a stock’s price history and future prospects

Charts

- Charts are a graphical representation of the stock's price over a given period of time
- Compared to tables, charts more clearly illustrate:
  - Reactions to important events
  - Past and present volatility
  - Historical volume and trading levels
  - Relative strength versus the overall market
- Technical analysts ("technicians") look for past patterns in charts to foreshadow future price movement

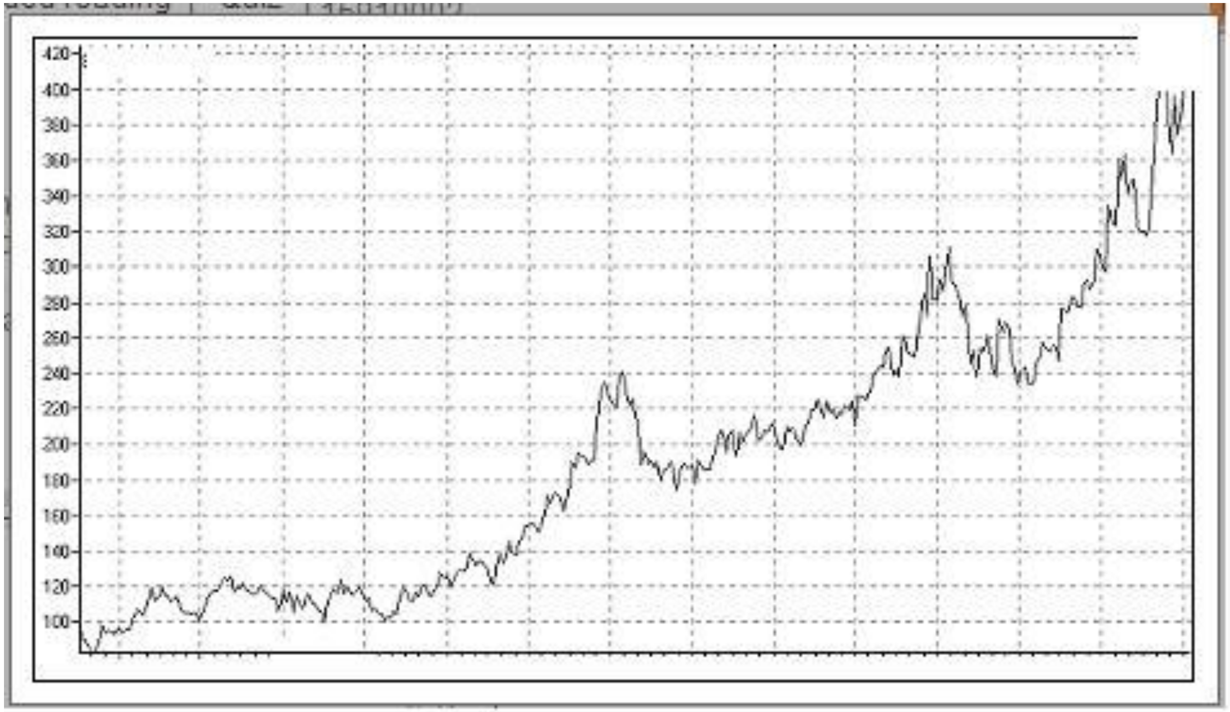
Types of Charts

- Depending on your trading style, there are three basic types of charts used by traders:
  - Bar charts
  - Line charts
  - Candlestick charts

Line Charts

- Connects a series of prices together with a line
- A line chart is the most basic type of chart used in finance

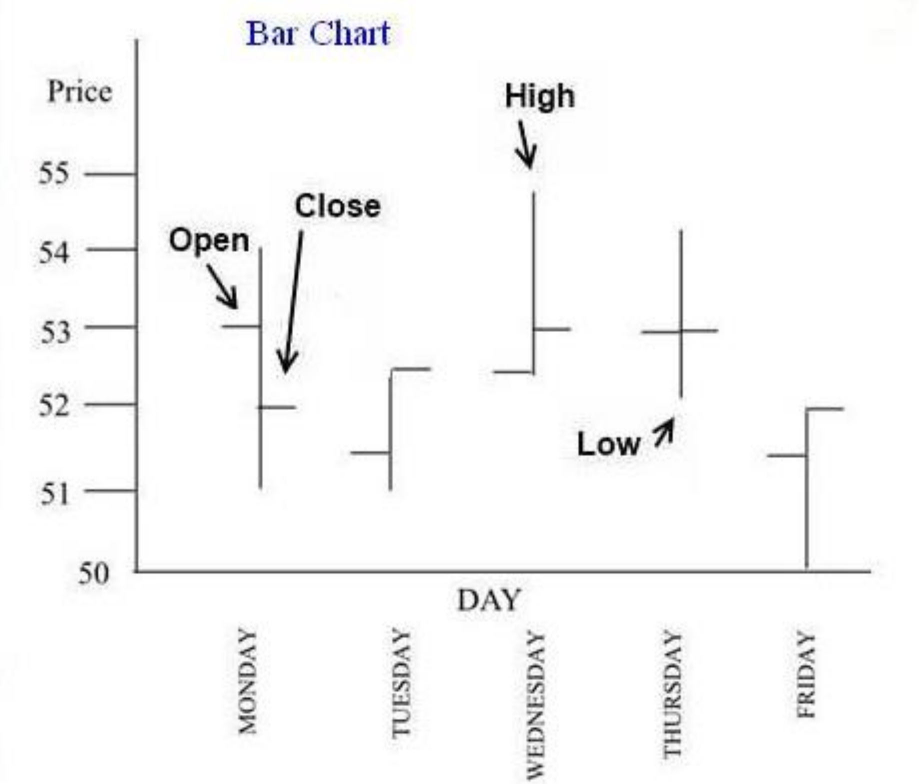
Line Charts


420
400
380
360
340
320
300
280
260
240
220
200
180
160
140
120
100

Bar Charts

- Each bar represents a certain amount of time
- The top of the vertical line indicates the highest price a security traded at during the day – the bottom represents the lowest price
- The closing price is displayed on the right side of the bar – the opening price is shown on the left side of the bar

Bar Charts


Bar Chart
Price
55
54
53
52
51
50
Open
Close
High
Low
DAY
MONDAY
TUESDAY
WEDNESDAY
THURSDAY
FRIDAY

Candlestick Charts

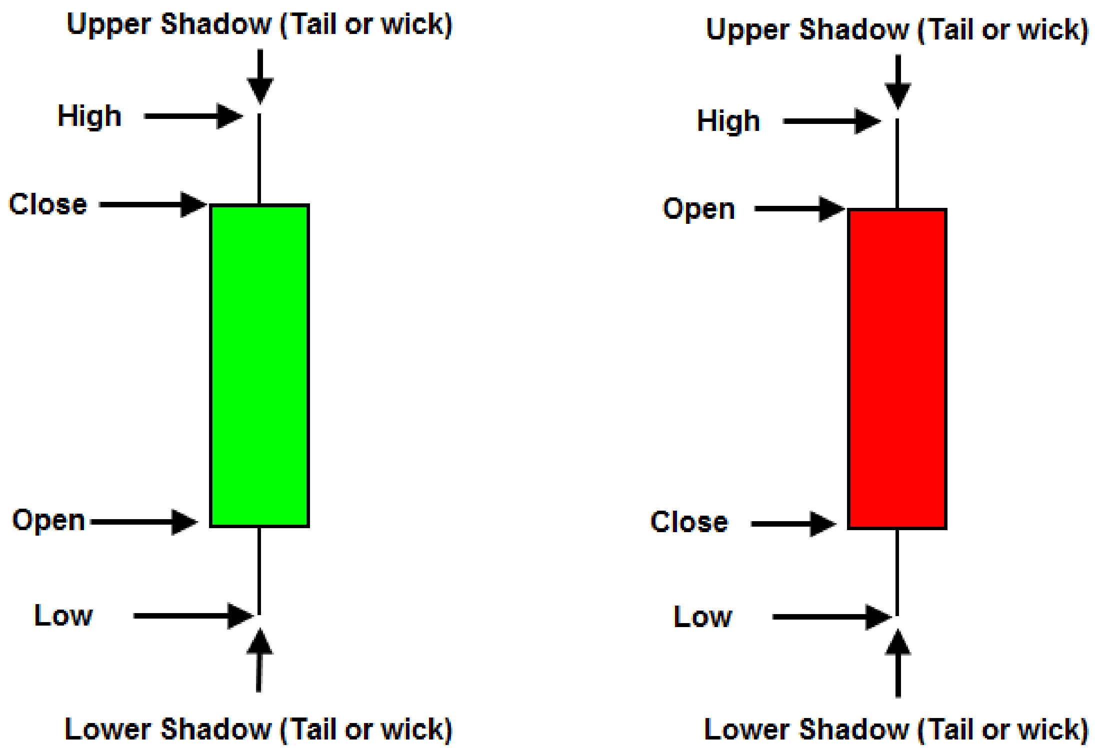
- A chart that displays the high, low, opening and closing prices for a security for a single day
- The wide part of the candlestick is called the “real body” and tells investors whether the closing price was higher or lower than the opening price (black/red if stock closed lower, white/green if the stock closed higher)

Candlestick Charts

(cont.)

- The candlestick’s shadow, or wick, shows the day’s highs and lows and how they compare to the open and close
- A candlestick’s shape varies based on the relationship between the day’s high, low, opening and closing prices

Candlesticks



Candlestick Charts

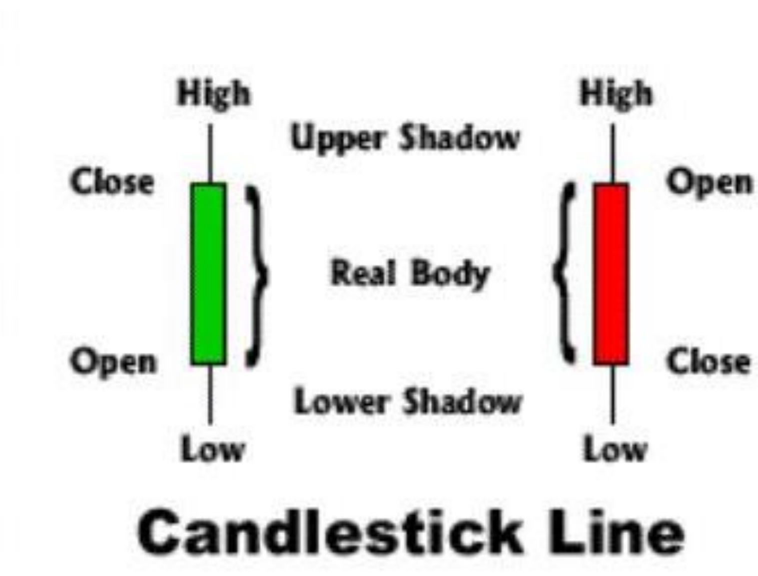


Chart Patterns

- There are many different chart patterns, but the most important ones to know are:
  - Trends
  - Support
  - Resistance
  - Trading Range
  - Breakout

Trends

- There are three different types of trends:
  1. Uptrends
  2. Downtrends
  3. Sideways trends

Trends

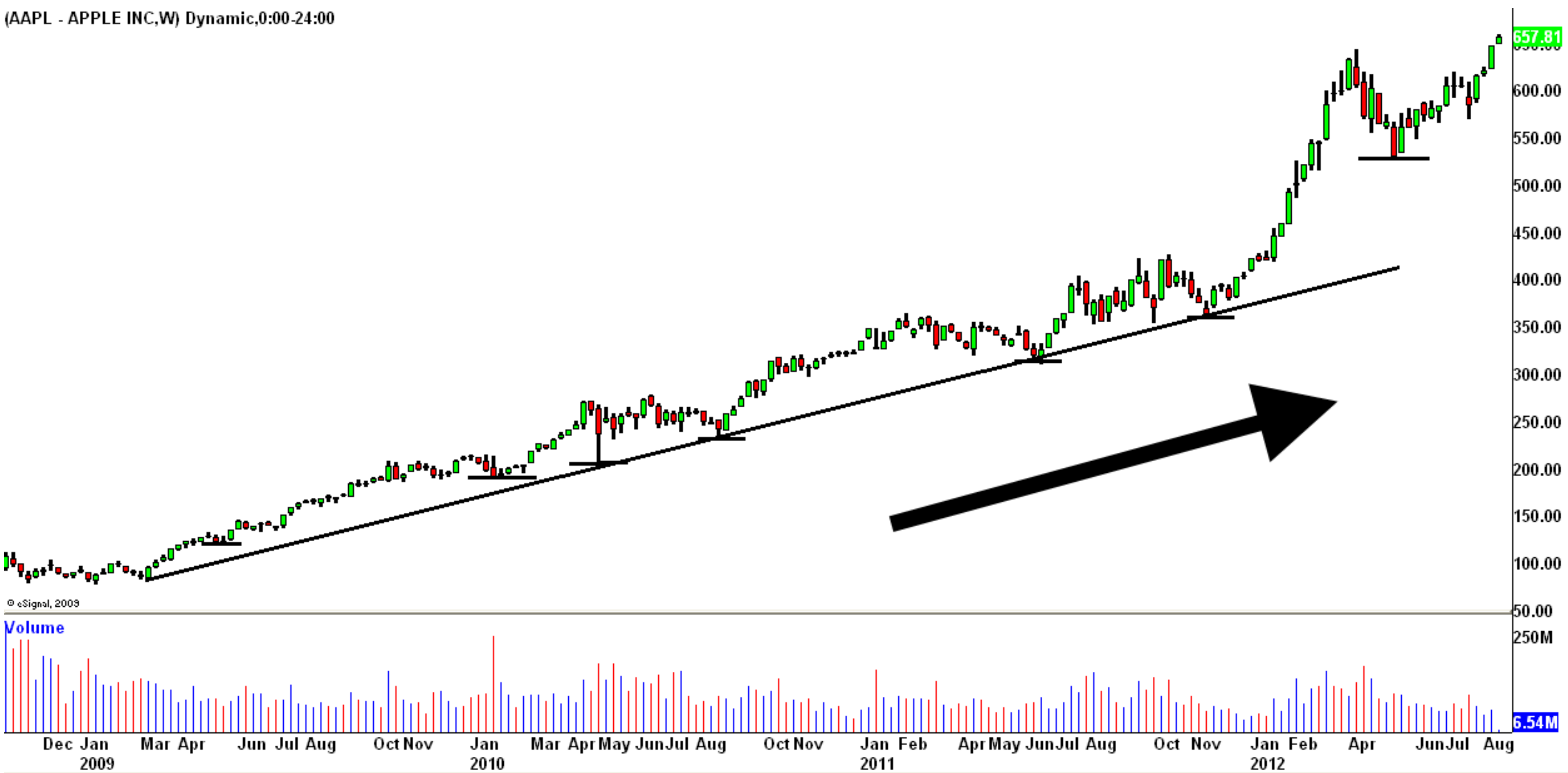
- There are two different ways to identify trends:
  1. Trend lines
     - A line that is drawn over pivot highs and/or under pivot lows to show the prevailing direction of price
  2. Moving Averages
     - An indicator used frequently in technical analysis that shows the average price over a certain period of time

Recognizing Trends

- Bullish trend
  - As long as price remains above its uptrend line or selected moving averages, the trend is considered bullish
- Bearish trend
  - If the price remains below its downtrend line or selected moving averages, the trend is considered bearish

Uptrend

- An uptrend occurs when there is a series of higher lows.



Downtrend

- A downtrend occurs when there is a series of lower highs.

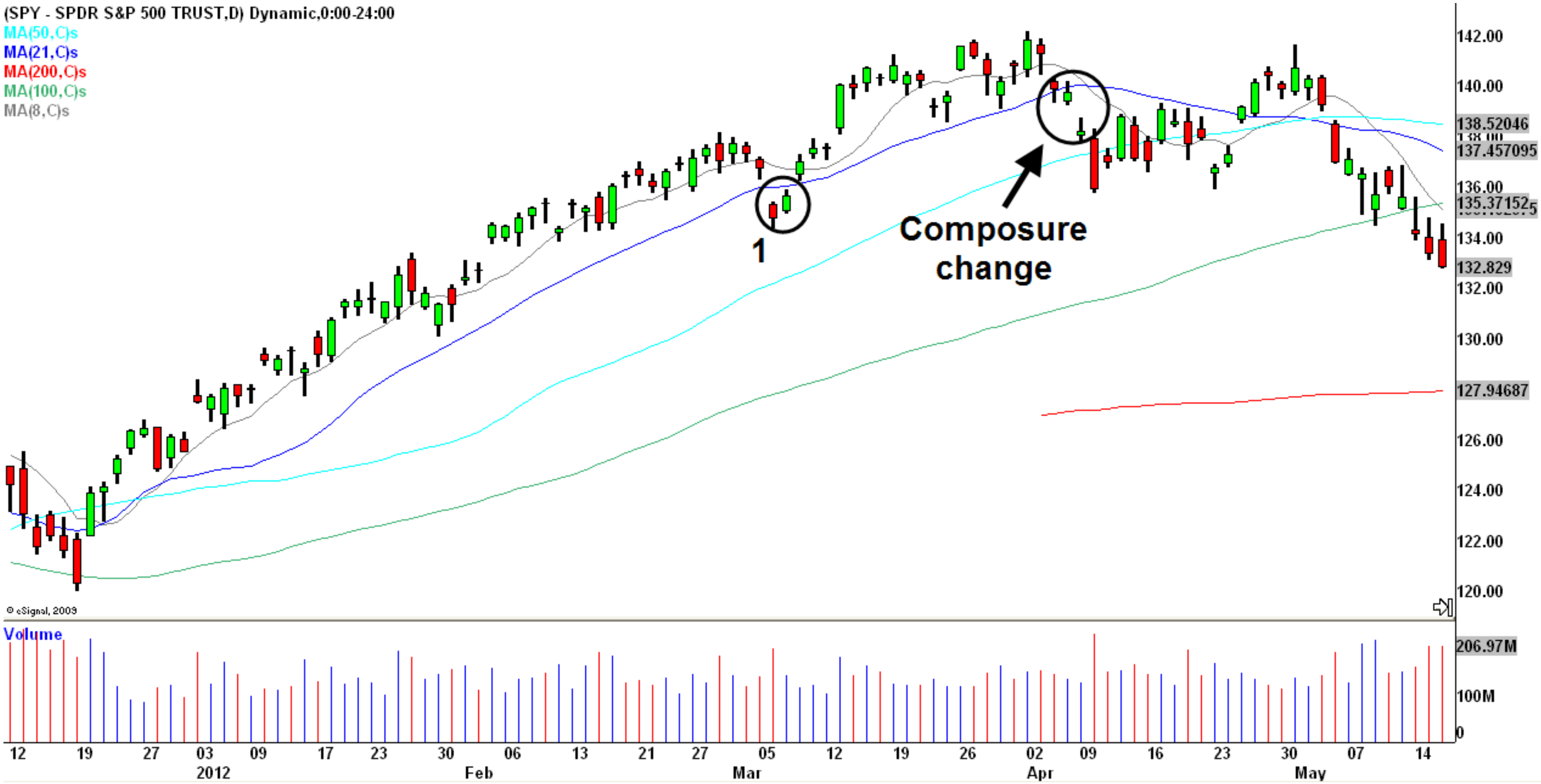
Sideways Trend

- A sideways trend is formed when a stock is unable to make higher highs or lower lows.

Trends – Moving Averages

- Moving Averages
  - Help to 1) define the trend and 2) recognize trend changes
  - Moving averages are generally used to measure momentum and define additional areas of possible support and resistance
  - Moving averages are used to emphasize the direction of a trend and to smooth out price volume fluctuations (“noise”) that can cloud interpretation
  - Upward momentum is confirmed when a short-term moving average (10- or 20-day) crosses above a longer-term moving average, and vice versa

Moving Averages

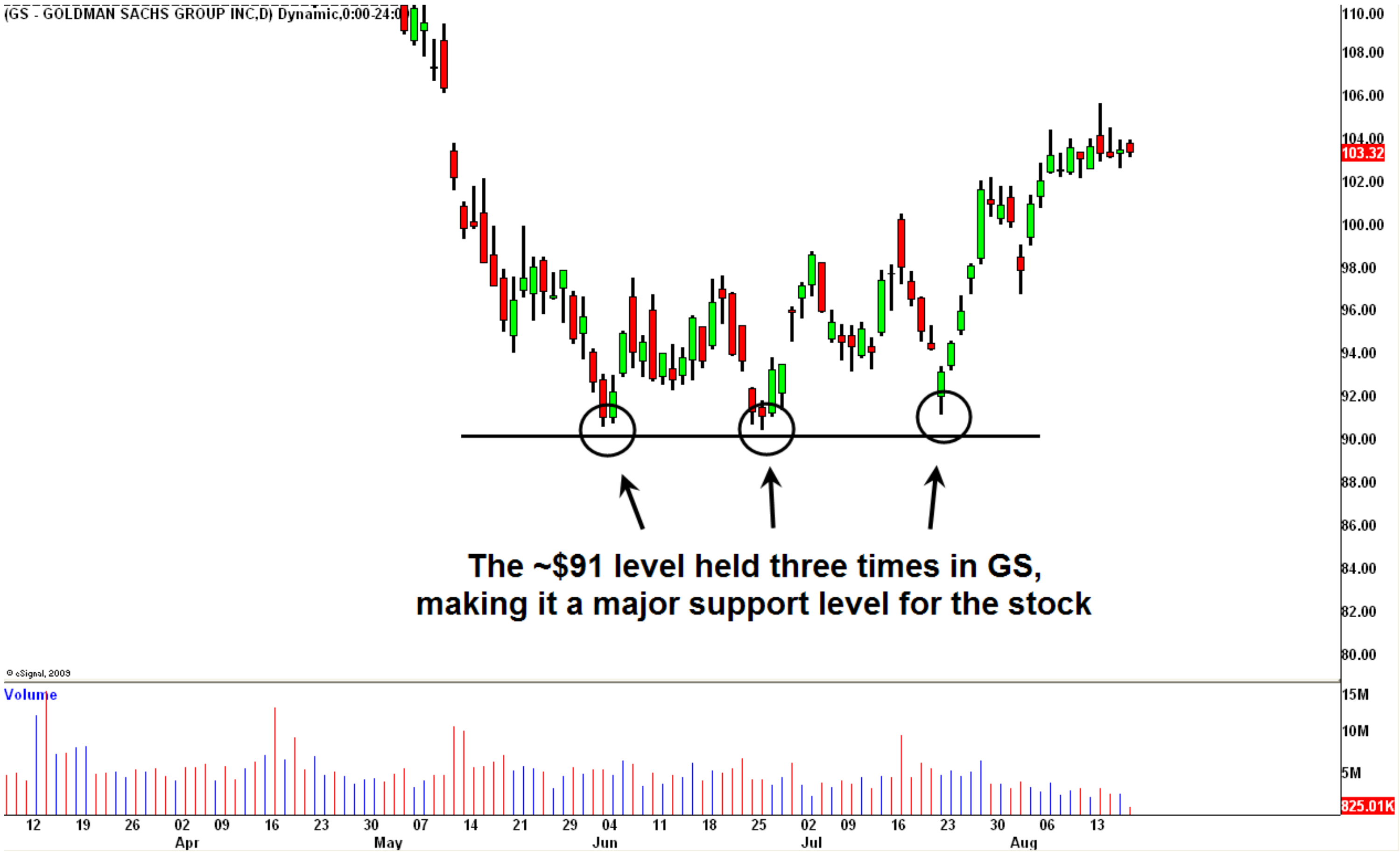


What is Support?

- Support is a price level that a stock has historically had difficulty falling below.

- A support level is an action area—not a clear buy or sell point.

Support


(GS - GOLDMAN SACHS GROUP INC,D) Dynamic,0:00-24:0
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108.00
106.00
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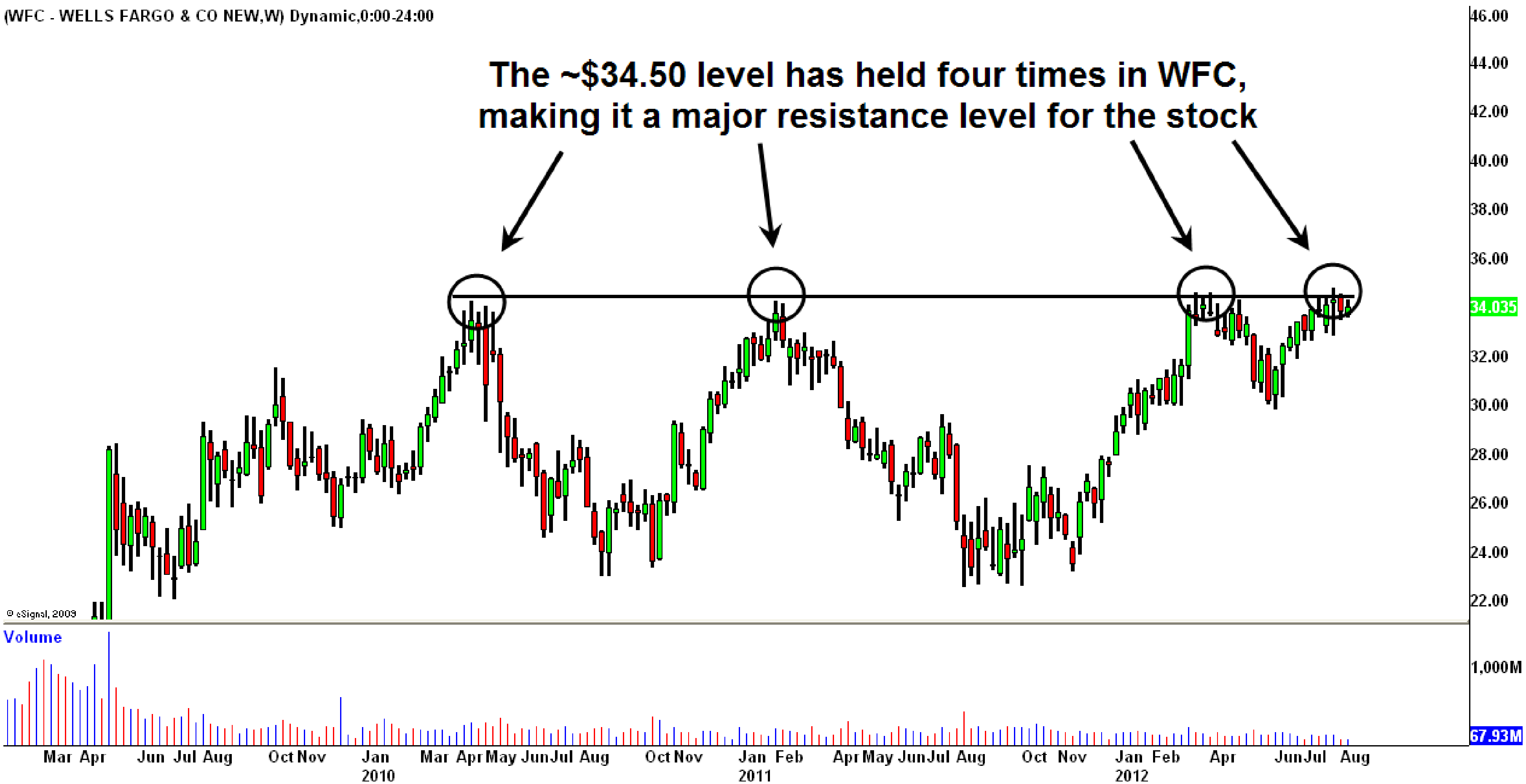
92.00
90.00
88.00
86.00
84.00
82.00
80.00
The ~$91 level held three times in GS,
making it a major support level for the stock
© eSignal, 2009
Volume
15M
10M
5M
825.01K
12
19
26
02
09
16
23
30
07
14
21
29
04
11
18
25
02
09
16
23
30
06
13
Apr
May
Jun
Jul
Aug

What is Resistance?

- Resistance is a price level that a stock has historically had difficulty climbing above.

- A resistance level is an action area—not a clear buy or sell point.

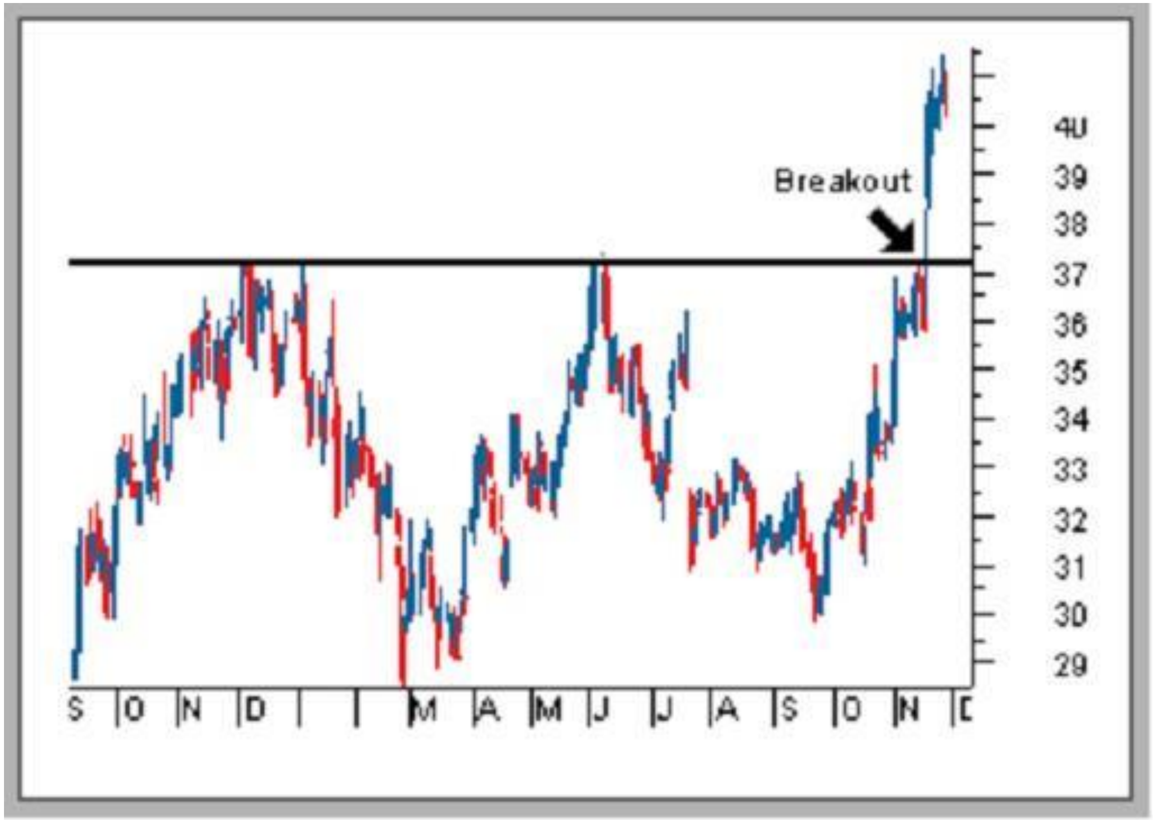
Resistance


(WFC - WELLS FARGO & CO NEW,W) Dynamic,0:00-24:00
The ~$34.50 level has held four times in WFC,
making it a major resistance level for the stock
46.00
44.00
42.00
40.00
38.00
36.00
34.035
32.00
30.00
28.00
26.00
24.00
22.00
© eSignal, 2009
Volume
1,000M
67.93M
Mar Apr Jun Jul Aug Oct Nov Jan Mar Apr May Jun Jul Aug Oct Nov Jan Feb Apr May Jun Jul Aug Oct Nov Jan Feb Apr Jun Jul Aug
2010
2011
2012

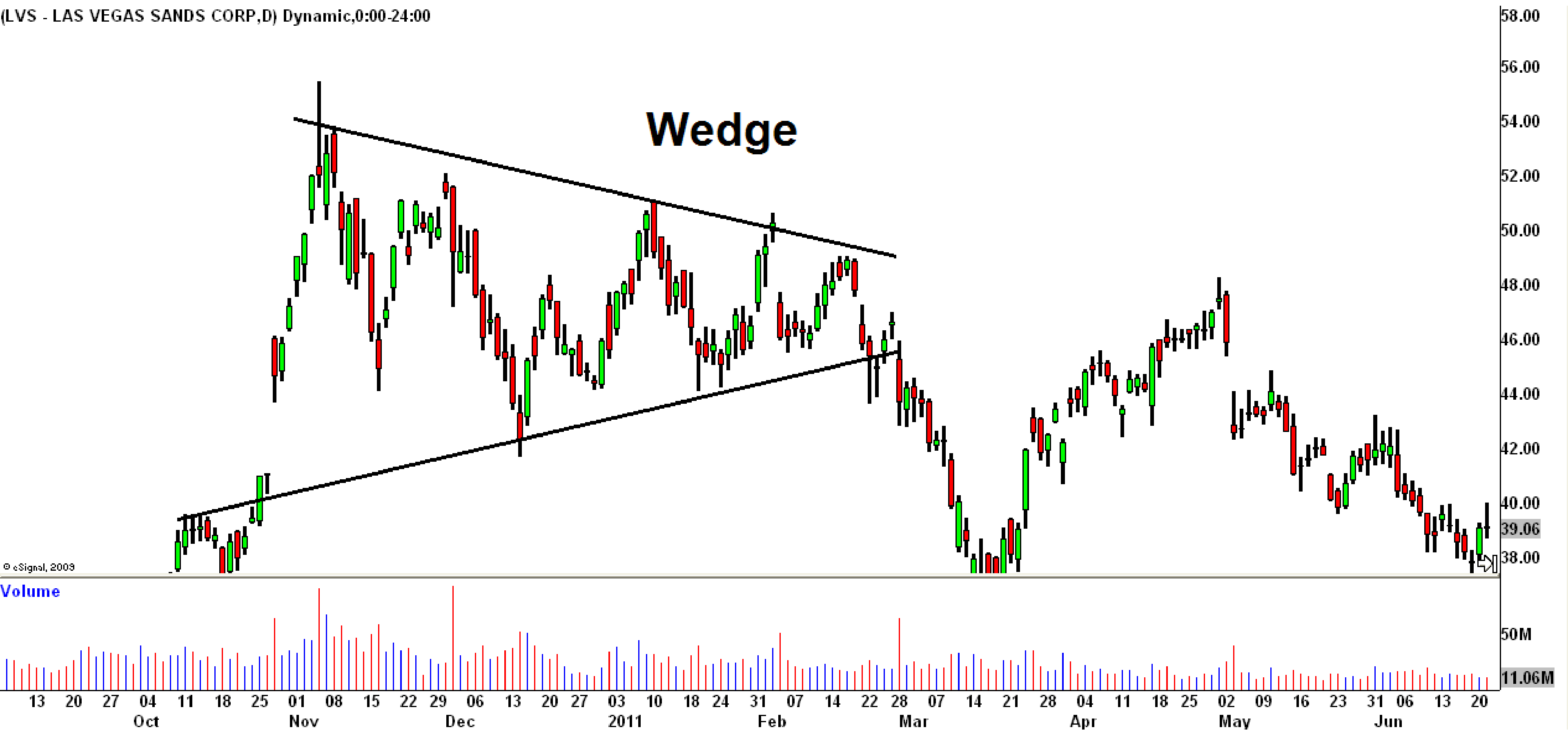
Breakout

- A price movement through an identified level of support or resistance, which is often accompanied by heavy volume and increased volatility
- Technicians will often buy the underlying asset when the price breaks above a level of resistance and sell when it breaks below

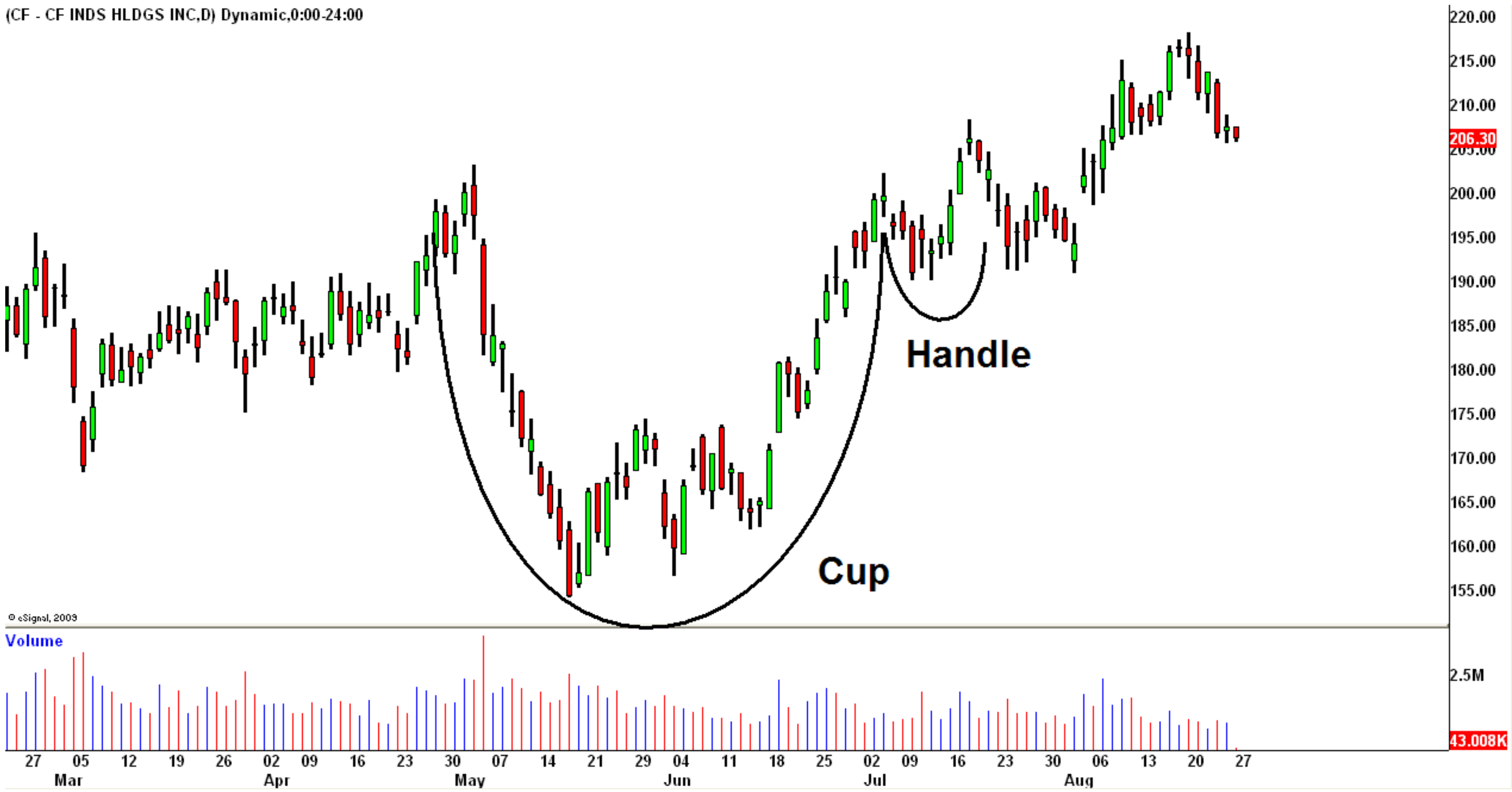
Breakout



Wedge Pattern



Cup and Handle



Head and Shoulders

Different Types of Orders and Using an Online Broker

Objectives

1. Learn the two most commonly-used order types: Market and Limit
2. Explain a Stop Order
3. Learn how time and size play a role in placing orders
4. Demonstrate how to place an order
5. Learn to embrace technology and use conditional orders
6. How to choose an online broker

Market Orders

- A market order is an order to buy or sell a stock at the current best available quoted price
- Generally, market orders will be executed immediately
- However, the price at which the market order will be executed is not guaranteed
  - Last-traded price is not necessarily the price at which order will be executed
  - In fast-moving markets, execution price often deviates from "real-time" quote, and order can be executed at different prices

Limit Orders

- A *limit order* is an order to buy or sell a stock at a specific price or better
- A *buy limit order* can only be executed at the limit price or lower; A sell limit order can only be executed at the limit price or higher
- A *limit order* is not guaranteed to execute; it can only be filled if the stock's market price reaches its limit price
- *Limit orders* do not guarantee execution, but they ensure that an investor pays no more than pre-determined price

Stop Orders

- A *stop order*, also referred to as a stop-loss order, is an order to buy or sell a stock you already "own" once it reaches a specified price, known as the stop price
- When the stop price is hit, the stop order becomes a market order
- A buy-stop order is entered at a stop price above current market price; a sell-stop order is entered below market
  - Investors generally use: a buy stop order to limit a loss or protect a profit on a stock they sold short, and a sell-stop order to limit a loss or protect a profit on a stock that they own

Stop-Limit Orders

- A *stop-limit order* is an order to buy or sell a stock that combines the features of a stop order and a limit order
- Once the stop price is reached, a stop-limit order becomes a limit order that will be executed at the specified price (or better)
- Benefit of a stop-limit order is that the investor can control the price at which the order can be executed

Trailing Stop Orders

- A *trailing stop order* is either a stop loss or stop limit order in which the price of the stop adjusts automatically when market conditions move in your favor
- A trailing stop helps protect profits while providing downside protection
- With a trailing stop order you do not have to manage your open stop orders by constantly adjusting for price changes

Trailing Stop Orders

(cont.)

- Trailing stop loss orders trigger a market order
- Trailing stop-limit orders trigger a limit order
- Trailing stop orders can be set with a percentage (%) or dollar ($) trail value
- Trailing stop triggers can be based on a stock’s last trade, bid or ask

Time In-Force

(How Time Plays a Role in Placing Orders)

- Day Orders
  - Day Orders are only good during that trading day
  - Unless an investor specifies a different time frame for the expiration, orders are considered day orders
  - Can be applied to market or limit orders
- Good-Til-Cancelled Orders (GTC orders)
  - GTC orders to buy or sell a stock last until the order is completed or cancelled (can be applied to market or limit orders)
  - Brokerage firms typically limit the length of time an investor can leave a GTC order open, and can change across brokers

Time In-Force

(How Time Plays a Role in Placing Orders)

(cont.)

- Immediate-Or-Cancel Orders (IOC orders)
  - IOC orders to buy or sell a stock must be executed immediately or cancelled
  - Any portion of the order that can't be filled immediately will be cancelled
  - IOC orders can be applied to market or limit orders

How Size Plays a Role in Placing Orders

- Fill-Or-Kill Orders (FOK Orders)
  - A *Fill-or-Kill* order must be executed immediately in its entirety
  - If order cannot be filled in its entirety, the entire order will be cancelled; there is no partial execution allowed
- All-Or-None Orders (AON Orders)
  - An *All-or-None* order must be executed in its entirety, or not at all
  - However, unlike FOK orders, AON orders that cannot be executed immediately remain active until they are executed or cancelled

Conditional Orders

- A conditional order is an order that will be executed or cancelled only if another order is executed first
- Conditional orders allow traders to enter a trade without having to constantly monitor the market
- This allows for a greater customization of the order to meet the specific needs of the investor

Conditional Orders

(cont.)

- A conditional order triggers based on any one of the eight trigger values for a stock, or up to 40 selected indices (Last Trade, Bid, Ask, Volume, Change % Up, Change % Down, 52-week High, 52-week Low)
- Market, Limit, Stop-Loss, and Trailing Stop-Loss orders are available once the contingent criteria is met
- The conditional criterion and order can have a different Time-in-Force

Conditional Orders

(cont.)

- Because conditional orders are more complicated, not all brokerages accept them; the rules for how to place a conditional order may vary from one brokerage to another
- Some brokerages may only allow setting conditions for prices but not volume, so check with your broker

Contingent Orders

- A contingent order lets you place an order automatically when a condition you set for the price of a stock, option or index is met

Multi-Contingent Orders

- A Multi-Contingent Order triggers based on a combination of two trigger values for any stock or up to 40 selected indices
- The criteria can be linked by: “and at the same time,” “or” or “then”
  - “and at the same time” is chosen if both criteria must be met at the same time
  - “or” is chosen if either one of the criteria must be met
  - “then” is chosen if the criteria must be met in sequential order

One-Triggers-the-Other (OTO) Orders

- An OTO order actually creates both a primary and a secondary order. If the primary order executes, the secondary order automatically triggers
- An OTO order can help save you time: place a buy order as your primary order and then a corresponding sell-limit, sell-stop or sell-trailing stop at the same time
- Time-in-Force must be the same for both orders

One-Triggers-the-Other (OTO) Orders

(cont.)

- Trailing stop orders are available for either or both legs of the OTO
- If the primary order is cancelled, the secondary order is also cancelled
- If the secondary order is cancelled, the primary order remains open as a separate order

One-Cancels-the-Other (OCO) Orders

- With an OCO order two orders are live so that if either executes, the other is automatically cancelled
- Bracket orders—a pair of two orders for the same: title and direction, i.e. both to sell
  - One sell order is to realize the profit and the second is to lock in the loss, not to get even deeper

Queue

- Order priority rules encourage simple market and limit orders
- Market orders receive the highest priority, followed by limit orders

Differences Between Investing and Trading

Objectives

1. Explain the difference between trading and investing
2. Explain why I believe it is important to do both
3. Explain how to “classify” your money

Time Horizon

- Trading and investing are two very different methods of attempting to profit in the financial markets
- Investing involves holding positions for a longer period of time (generally more than one year)
- Trading involves buying and selling positions more frequently

Goal of Investing

- The goal of investing is to gradually build wealth over an extended period of time
- "Buy-and-hold" is a more passive approach to money management
- Investors are willing to "ride out" downtrends in the market with the expectation that over time the stock market will continue to rise
- Many people invest for retirement and take advantage of compounding through reinvesting dividends

Mutual Fund Investing

- A mutual fund is an investment vehicle made up of a pool of funds from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets
- They are operated by money managers who invest the fund's capital and attempt to produce capital gains
- Each mutual fund's portfolio is structured and maintained to match the investment objectives in its prospectus
- Gives small investors access to diversified, professionally managed portfolios

Goal of Trading

- The goal of trading is to generate returns that outperform buy-and-hold investing
- In trading, you buy and sell more frequently looking to take advantage of short-term price fluctuations in securities
- Traders are looking to generate full-time or supplemental income

Types of Traders

- Trading is a general term, and there are several different types of traders
  - *Position Trader*: positions are held from months to years
  - *Swing Trader*: positions are held from days to weeks
  - *Day Trader*: positions are held through the day only with no overnight positions
  - *Scalp Trader*: positions are held for seconds to minutes with no overnight positions

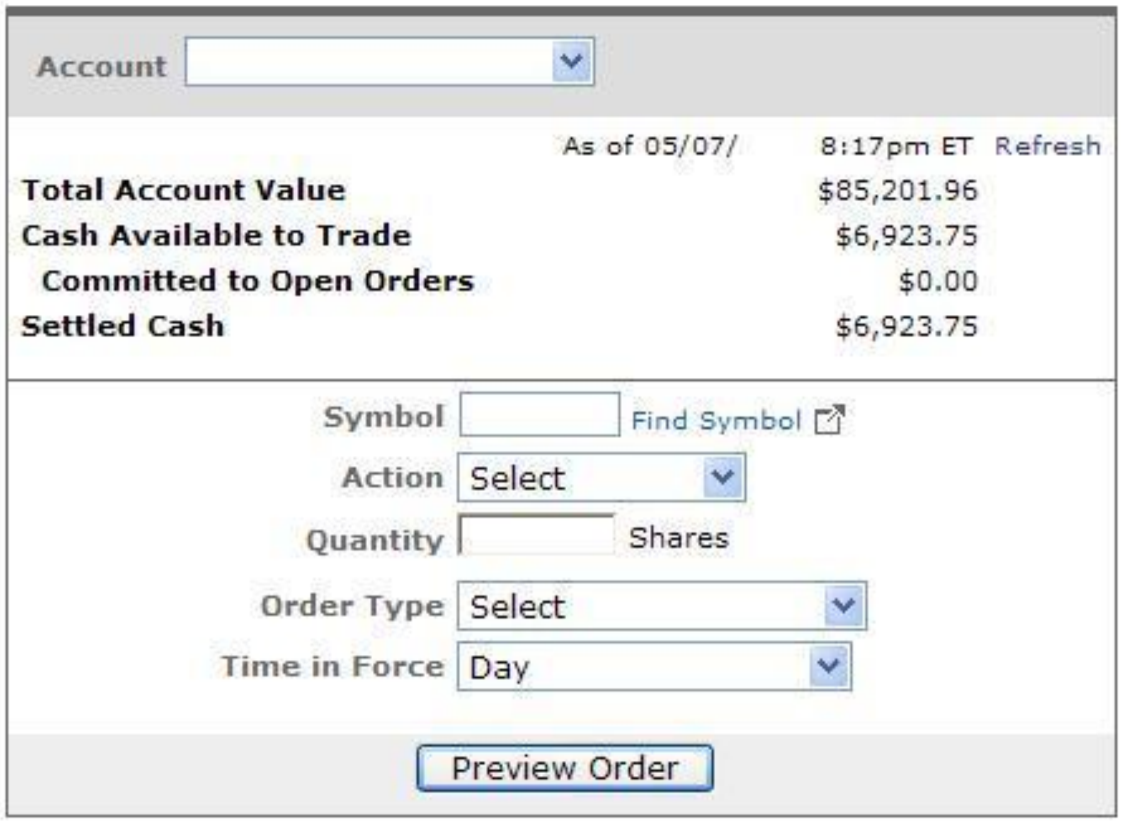
Should You Trade or Invest?

- Individuals should invest *and* trade; it doesn't have to be an "either, or" scenario
- Diversification
  - Investing: When adjusting for inflation, the stock market has produced an annual rate of 6.2% returns since 1928 (www.ifa.com)
  - Investing is "easier" because it is, for the most part, passive; you can throw your money into a mutual fund or index fund
  - With trading, the goal is to produce returns in excess of 6.2% per year. But to do that, you must be an educated trader

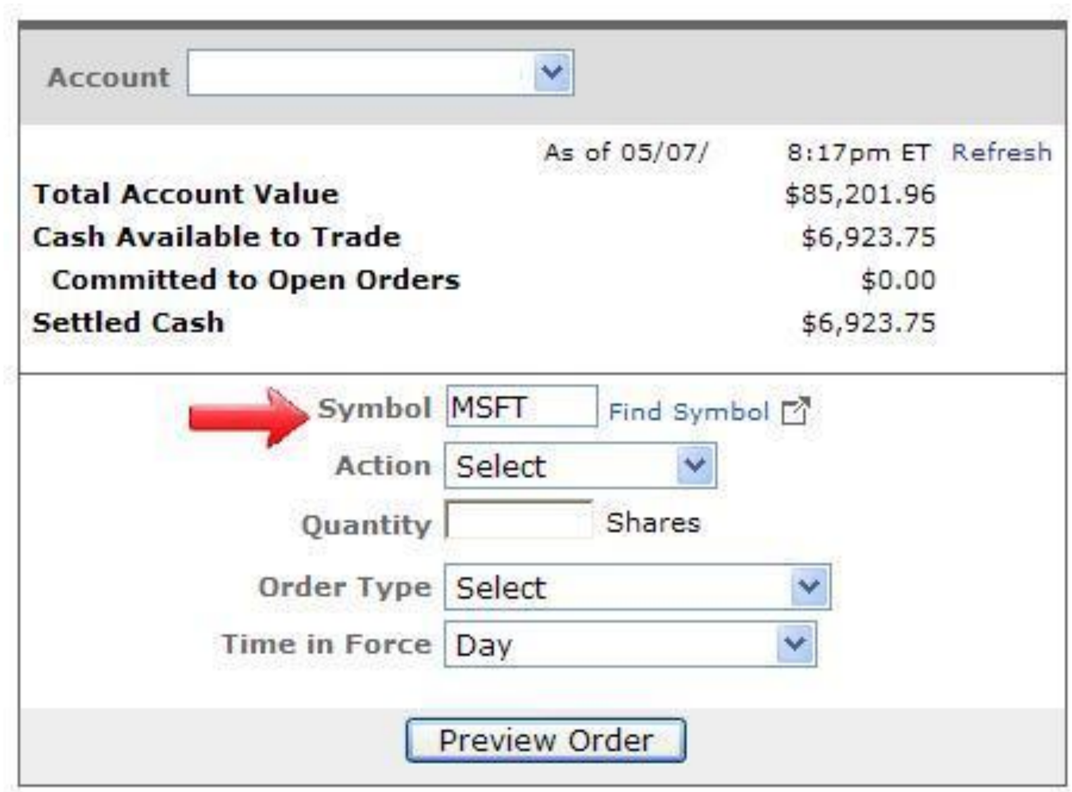
Classifying Accounts

- Keep any investing account money and trading account money separate
- Trying to mix the two can cause serious damage to your portfolio
- Trades should never become investments, and investments should never become trades

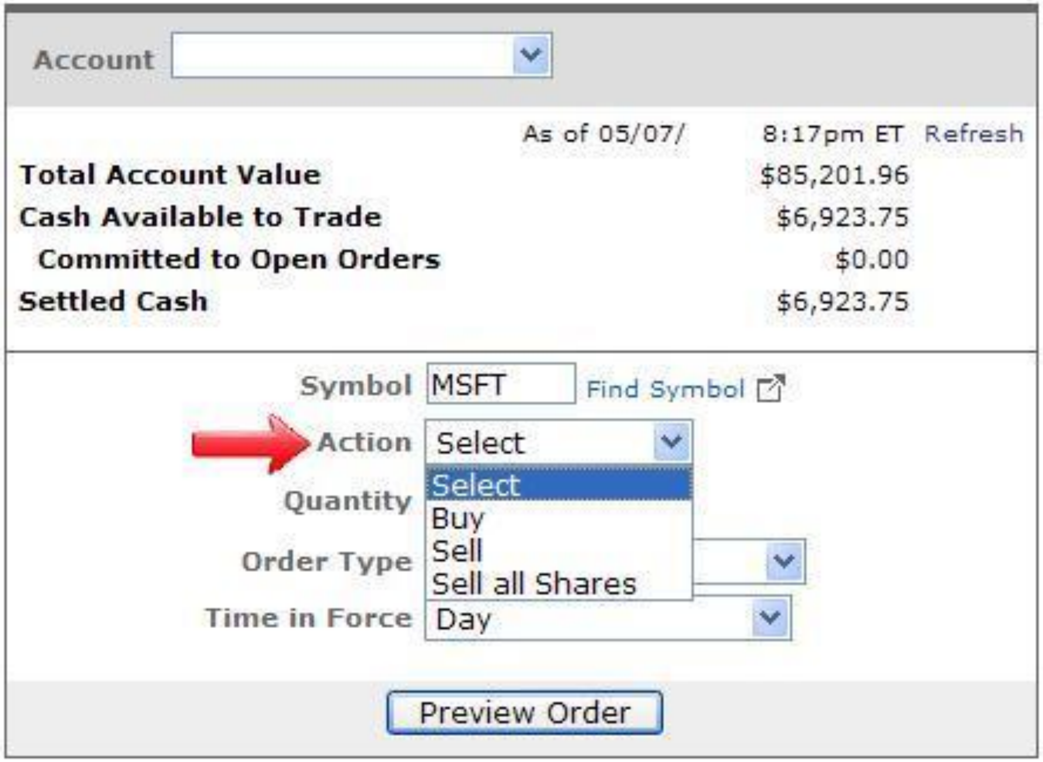
How to Place an Order



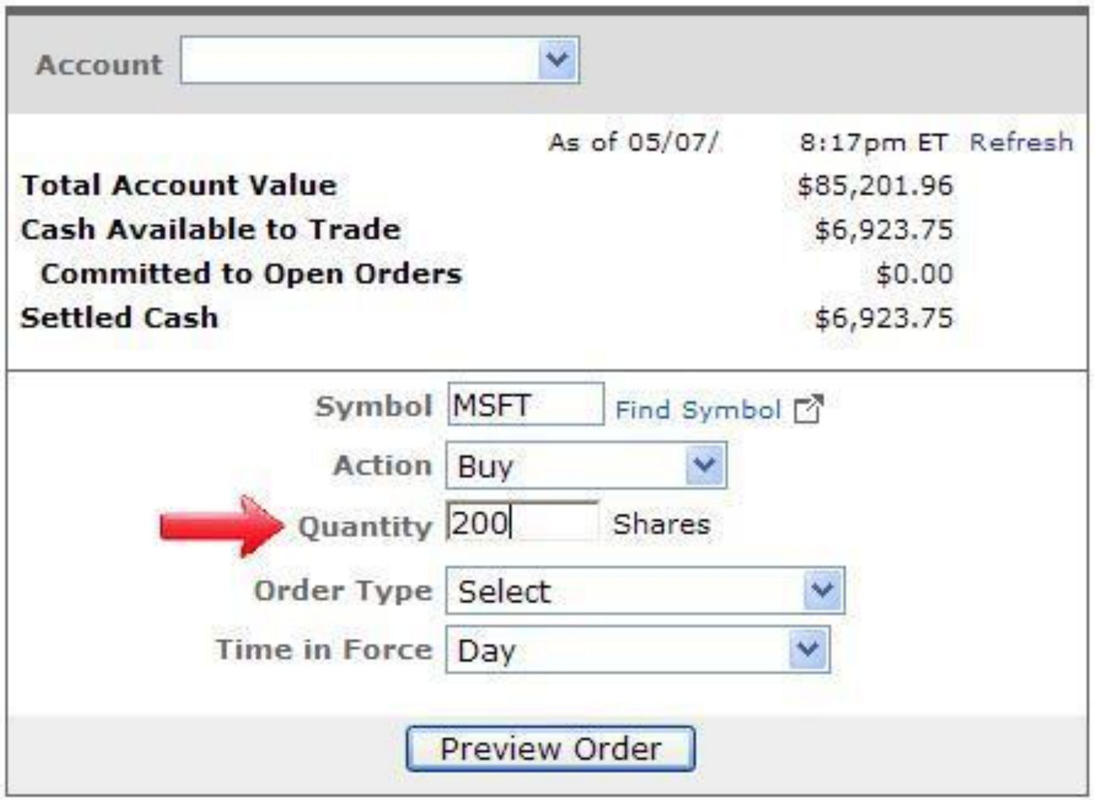
How to Place an Order



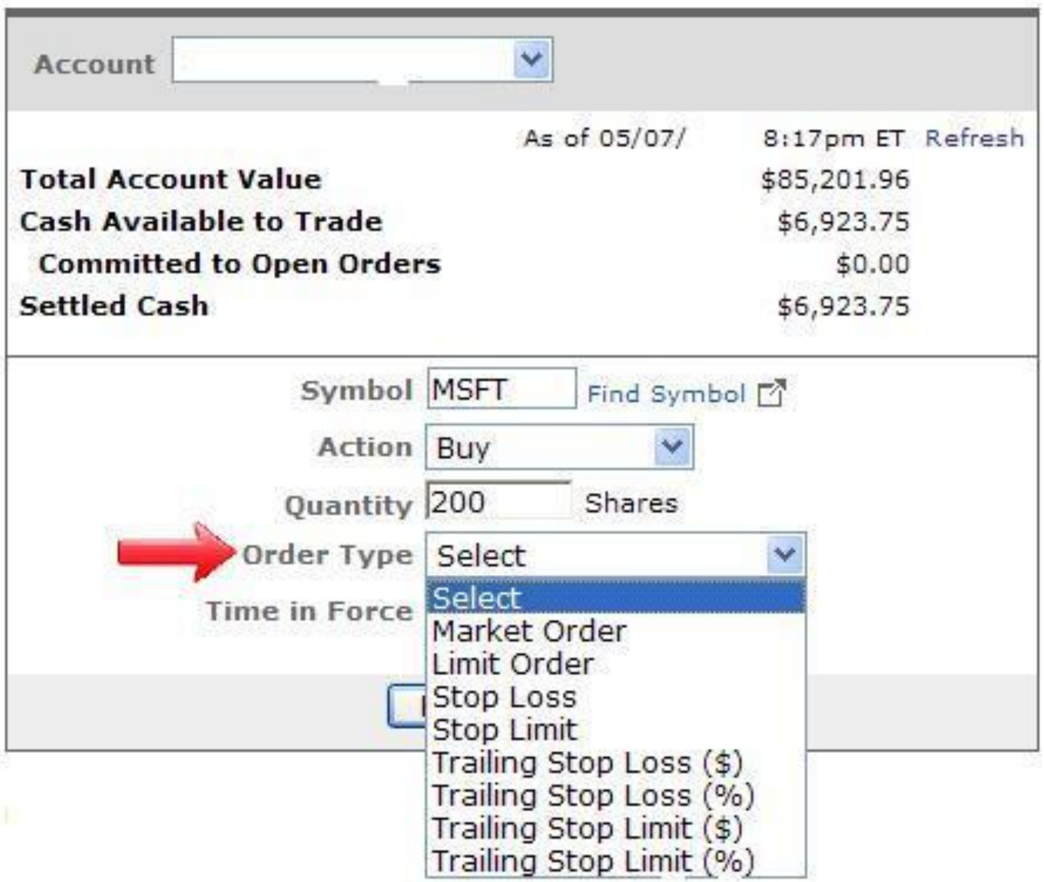
How to Place an Order



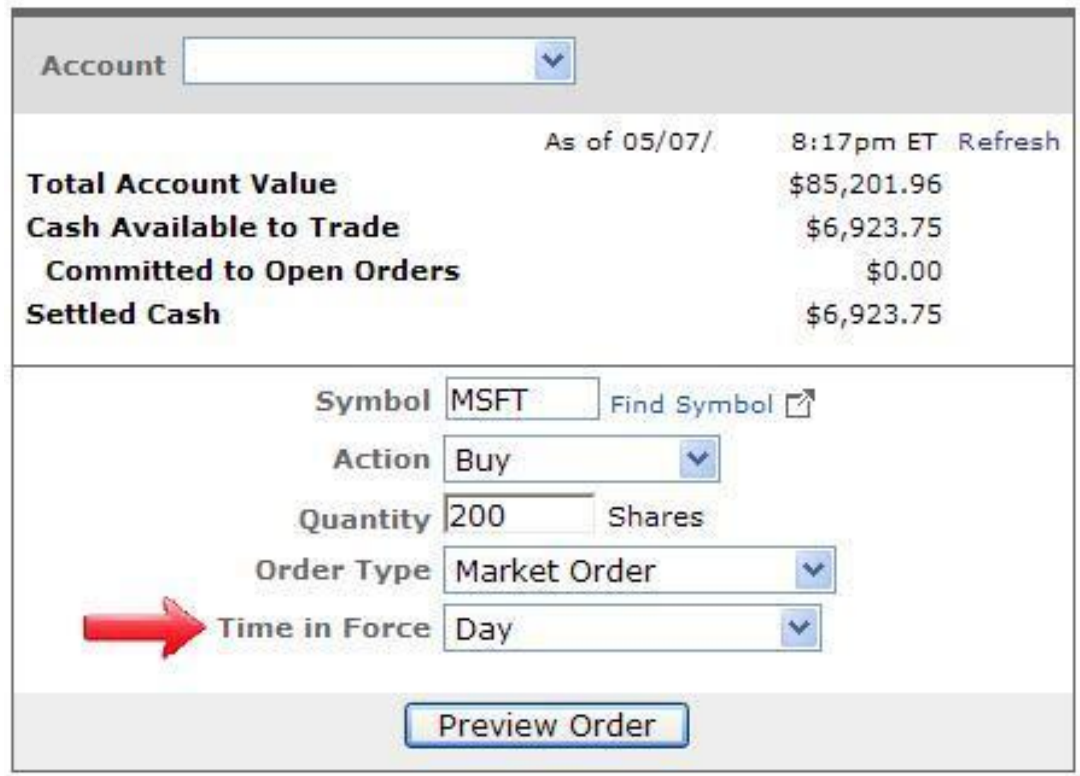
How to Place an Order



How to Place an Order



How to Place an Order



How to Place an Order

Verify your order below and click Place Order.

Order Information

Account	
Symbol	MSFT
Description	MICROSOFT CORP
Action	Buy
Quantity	200 Shares
Order Type	Market
Time in Force	Day
Conditions	None
Trade Type	Cash

Estimated Order Value:	**$6,662.00**
Estimated Commission:	**$7.95**
Estimated Order Value (including commission):	**$6,669.95**

< Edit Order   Place Order >

How to Choose an Online Broker and What are the Different Types of Brokerage Accounts

Objectives

1. Explain the different types of brokerage accounts
2. Explain how to determine which type of brokerage account is right for you
3. Explore different types of brokerage accounts

Online Brokers

Factors to consider when picking an online broker:

- Technology
  - Good web-based platform, reliable executions, conditional (contingent) orders, good mobile app
- Customer service
- Affordable commission structure
- Access to as many markets as possible

*Use review websites to find rankings for online brokers

Types of Brokerage Accounts

- Cash Account
- Margin Account
- Retirement Accounts
  - 401(k)
  - IRA
  - Roth IRA
  - SEP IRA
- 529 Plan

Cash Account

- Traditional brokerage account
- You deposit cash and use that cash to buy stocks or other assets
- The amount of cash you need to have on deposit varies by broker
  - Some let you open an account for as little as $100, while other require as much as $10,000

Margin Account

- In a margin account, the cash and securities in your account act as collateral for a line of credit that you take out from the brokerage in order to buy more stock
- Allows people who want to get more aggressive to buy more shares of a company that they otherwise could in a cash account
- There is a fixed interest rate on the money borrowed, which is determined by each brokerage house
  - The rate normally decreases as the amount borrowed increases

Margin Maintenance Requirement

- Percentage equity the investor must keep in his or her portfolio at all times
- Often 30-40%, so if a brokerage maintains a 30% maintenance requirement, it will lend up to $233 for every $100 an investor has deposited, giving the account holder the ability to purchase up to $333 in assets

Margin Maintenance Requirement

- If the value of your portfolio drops to near the margin maintenance requirement, the broker will issue a margin call, which requires the account holder to deposit additional cash or sell positions until the required equity relationship is restored
- It is possible to lose more than you invest when using margin. You will be legally responsible for paying any outstanding debt to the broker even if your portfolio is wiped out

Margin Account

- Margin accounts are the only accounts that can be used to short sell stocks. (A rule instituted by the Federal Reserve Board under Regulation T)

Retirement Accounts

- 401(k)
- IRA
- Roth IRA
- SEP IRA

401(k)

- A 401(k) is a retirement saving plan sponsored by an employer
- It lets workers save and invest a piece of their paycheck before taxes are taken out
- Taxes are not paid until the money is withdrawn from the account
- With a 401(k) you control how your money is invested, and most plans offer a spread of mutual funds

IRA

- IRA stands for Individual Retirement Account
- A traditional IRA is tax-deferred retirement saving account – you pay taxes on your money only when you make withdrawals in retirement
- Deferring taxes means all of your dividends, interest payments and capital gains can compound each year without being hindered by taxes, allowing an IRA to grow much faster than a taxable account
- You can trade stocks in an IRA

Roth IRA

- Different from a traditional IRA in that you fund a Roth with after-tax dollars, meaning you've already paid taxes on the money you put into it
- In return for no up-front tax break, you pay no taxes upon withdrawal
- Money grows tax-free inside all IRAs

SEP IRA

- A SEP IRA is a type of traditional IRA for self-employed individuals or small business owners
- SEP stands for Simplified Employee Pension
- Any business owner with one or more employees, or anyone with freelance income, can open a SEP IRA
- Contributions, which are tax-deductible for the business or individual, go into a traditional IRA in the employee's name (like a traditional IRA, the money in a SEP IRA is not taxable until withdrawal)

529 Plan

- A 529 Plan is a savings plan that is a simple way to save money for your kids' college education
- Not tax-deductible on the way in, but you pay no federal taxes on the account's earnings - there may also be state tax benefits as well
- Money from a 529 Plan may be used for tuition, fees, books, supplies and equipment required for study at any accredited college, university or vocational school in the United States, or at some foreign universities

Mitigating Risk

Education is Key to Trading Success

- “Risk comes from not knowing what you’re doing.” – Warren Buffet
- In all my years in this profession, I’ve never seen a successful trader that didn’t maintain a strong education
- Trading is NOT gambling
- Trading is like any other profession – doctor, lawyer, teacher, athlete – to be successful you need to put in time and effort to learn the craft

Have a Trading Plan

- A trading plan is a set of rules for you to follow
- Why are you buying stock? Where are you going to buy? How many shares are you buying? Where are you selling if it moves in your favor, or getting out if it doesn't?
- Never deviate from your plan, this way you will never lose your shirt
- Regularly adapt your trading plan to the market and make sure it is up-to-date

Size Matters

- Always think in terms of "how much am I are willing to lose?" rather than "how much do I want to make?"
- There are three criteria you should use to determine size in a trade:
  1. Price
  2. Volatility
  3. Volume

Don’t Chase

- Just because you miss a trade, don’t be tempted to chase a stock beyond your desired buy price
- You will rarely pick an exact top or bottom. You should only enter near your targeted price
- If you miss an entry, move on to the next trade or look for a pullback to potentially enter

Pay Attention to Earnings Dates

- Don’t hold short-term trades into earnings – that’s gambling
- Stocks can still beat “consensus expectations” and go down – you have to understand context
- Take advantage of free online earnings calendars, you can use Yahoo! Finance

Busy Markets vs. Quiet Markets

- Your level of aggression in the market should depend on what time of year you are trading
- There are times when the market is busier and times when it is slower (macro news can change this)
  - Busier = Earnings seasons
  - Slower = Holiday season, Summer

Avoid Carelessness

- If you are not going to be watching the market closely, make sure to cancel open orders and put in stop-loss orders for swing positions
- Leaving open positions when you are away is a mistake that can you thousands of dollars

How to Analyze a Stock

Fundamental Analysis

- Fundamental analysis is a method of evaluating a stock using measures of intrinsic value, including economic, financial and other qualitative and quantitative factors
  - Qualitative: non-quantifiable information, such as management expertise, industry circles, strength of R&D, and labor relations
  - Quantitative: focuses on company’s financial statements, especially ratios such as earnings-per-share, debt-to-equity and price-to-equity ratios

Fundamental Analysis

- In essence, fundamental analysis is the study of everything that can affect the security's value, including macroeconomic factors (like overall economy and industry conditions) and company-specific factors (like financial condition and management)
- The goal of performing fundamental analysis is to produce a value that an investor can compare with the security's current price, with the goal of figuring out what type of position to take
  - Underpriced = buy, Overpriced = sell or short

Top-Down vs. Bottom-Up Analysis

- There are two different approaches to fundamental analysis:
    1. Top-Down Analysis
    2. Bottom-Up Analysis

Top-Down Analysis

1. Top-Down Analysis
   – The “big picture” macroeconomic factors are looked at first (global economics, domestic economic indicators, inflation, interest rates, etc.) then the industry, sector and individual company are explored, in that order
   – The assumption is that the company’s success hinges largely on macro economic factors

Bottom-Up Analysis

1. Bottom-Up Analysis
   – The opposite of Top-Down Analysis (naturally)
   – The primary focus is on the individual company, then the sector, then the “big picture” factors
   – The assumption is that the company’s success can diverge from the economic health of the industry, sector or global economy

Market Psychology

Market Psychology

- Patience
  - Wait for the proper set-up for the proper trade.
- Discipline
  - Be ready to make a proper trade.
  - Be prepared to take profits or get out of a losing trade.
- Analogy
  - Think of a lion waiting for its prey to pass by.

Market Psychology

- Take the emotions out of trading
  - Everyone makes wrong trades, do not beat yourself up when they happen.

Market Psychology

- Have a Trading Plan
  - Which stock do you want to get into?
  - How will you enter that trade?
  - Where will you get out if you're wrong?
  - Where will you get out if you're right?

Market Psychology

- The Stock Market is your boss
  - The market alone decides when it is or isn't a good time to trade. You have no say.
- Analogy
  - Surfers check the ocean to see when it's a good time to surf. Similarly, traders should check the market to see when it’s a good time to trade.
- Be consistent in your approach

Market Psychology

- Size Matters
  - Don't make your positions too big, too fast
  - Don't rush into a position

Market Psychology

- Keep track of your progress
  - Rather than focus on your results day-to-day, analyze them on a week-to-week or month-to-month basis
  - Don't beat yourself up over a bad day

- Adapt to changes in the market

- Keep a trading journal

Bonds, Options, Futures, Forex and ETFs

Bonds

- The bond market is also known as the credit or fixed income market
- Bonds can also be called debt securities or debt obligations
- Fixed income securities are generally classified by time to maturity
  - Bills mature in under 1 year
  - Notes mature in 1 to 10 years
  - Bonds mature in more than 10 years

Bonds

- When you purchase a bond, you are lending money to a government, municipality, corporation, federal agency or other entity known as an *issuer*
- In return for that money, the issuer provides you with a bond that promises to pay a specified rate of *interest* during the life of the bond and to repay the *face value* of the bond (the *principal*) when it matures, or comes due
- Government securities typically have low risk and, as such, offer low returns

Bonds

- Among the types of bonds available for investment are: US government securities, municipal bonds, corporate bonds, mortgage- and asset-backed securities, federal agency securities and foreign government bonds
- The vast majority of trading volume in the US bond market takes place between broker dealers and large institutions, not between individual traders

Options

- Options are contracts that grant the holder the right (but not the obligation) to buy or sell a specific asset at a specific price before the contract expires
- There are two types of options:
  - Call options
    - Give the holder the right to buy a stock at a specific price before the contract expires
  - Put options
    - Give the holder the right to sell a stock at a specific price before the contract expires

Call Option - Example

- Call option
  - Assume MSFT shares are trading at $35 right now. You bought a call stock options contracts for X amount of money that allows you to buy MSFT shares at $35 anytime before the option expires in a month's time
  - One month later, MSFT shares are trading at $38, but you still own the right to buy shares at $35 through the call options
  - You exercise your call option and buy the shares (100 shares per contract) for $35 from the seller, and are profitable $3 per share

Put Option - Example

- Put option
  - Assume you own XOM shares, which are trading at $90 right now. You bought a put options contract for a X amount of money that allows you to sell your XOM shares for $90 anytime before the contract expires in two months
  - Two months later, XOM shares are trading at $80, but you still own the right to sell them at $90 through the put options

Options

- There are two reasons why traders use options:
  1. Speculate: Try to profit from movement in the underlying stock
  2. Hedge: Reduce risk or lock-in gains on a previously held asset

- The world’s largest options exchange is the Chicago Board of Options Exchange (CBOE)

Futures

- Futures are financial contracts that obligate the buyer to purchase an asset, or the seller to sell an asset, such as a physical commodity or a financial instrument, at a pre-determined future date and price
- Just like options, futures can be used either to speculate or hedge on the price movement of the underlying asset
  - For example, a producer of soybeans could use soybean futures to lock in a certain price and reduce risk (hedge)
  - Anyone can also speculate on soybean prices going up or down

Futures

- Futures differ from options because the holder of a futures contract is *obligated* to fulfill the terms of his/her contract, while the holder of an option has only the *right* to buy or sell the underlying asset up until expiration
- However, in real-life application, the delivery rate of the underlying goods in futures contracts is very low
- Futures mostly deal with commodities and indexes, while options mostly pertain to stocks and ETFs
- The CME is the world’s leading marketplace for futures

Forex

- The Forex (or foreign exchange) market is where currencies are traded
- The Forex market is the largest, most liquid market in the world with an average traded value that exceeds $1.9 trillion per day and includes all of the world's currencies

Forex

- There is no central marketplace for currency exchange; trade is conducted over-the-counter
- The Forex market is open 24 hours-a-day, five days-a-week, and currencies are traded worldwide among the major financial centers of London, New York, Tokyo, Zurich, Frankfurt, Hong Kong, Singapore, Paris and Sydney

ETFs

- An ETF (Exchange Traded Fund) is a security that tracks an index, commodity, sector, or basket of alike stocks, but trades like a stock on the exchange
- Though the nature of ETFs is similar to that of mutual funds, ETFs experience price changes throughout the day as they are bought and sold
  – Rather than having Net Asset Value (NAV) like a mutual fund, an ETFs price is determined in the open market like a stock's

ETFs

- Advantages of owning ETFs rather than mutual funds include:
  1. Diversification while at the same time having the ability to sell short, buy on margin and purchase as little as one share
  2. The expense ratios for most ETFs are lower than those of the average mutual fund
     - When buying and selling ETFs you have to pay the same commission to your broker as you'd pay on any regular stock order
     - There are also management fees built into ETFs, but they are generally lower than management fees for mutual funds

ETFs

- ETFs have revolutionized and democratized Wall Street by allowing average investors to gain cheaper and easier access to every corner of the investable universe
- ETFs are run by investment management companies like BlackRock (iShares), State Street (SPDR) and Vanguard

ETFs - Examples

- (SPY) - SPDR S&P 500 ETF
  – Tracks the performance of the S&P 500 index
  – The most heavily traded ETF in the world
- (XHB) – SPDR S&P Homebuilders ETF
  – Corresponds to the performance of a basket of stocks relating to the housing and homebuilding sector
  – The top five holdings are: Williams-Sonoma (WSM), Tempur-Pedic (TPX), Select-Comfort (SCSS), Bed Bath & Beyond (BBBY) and Ryland (RYL)

ETFs - Examples

- (GLD) – SPDR Gold Trust ETF
  - Seeks to replicate the performance of gold bullion
- (TLT) – iShares Barclays 20+ Year Treasury Bond ETF
  - Seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of the Barclays US 20+ Year Treasury Bond Index
- (FXE) – CurrencyShares Euro Trust ETF
  - A currency ETF seeks to track the price of the Euro vs. a basket of other currencies, including the dollar

Leveraged ETFs

- Leveraged ETFs also exist, meaning they track the price of an index, commodity, or basket of stocks magnified by a multiple, usually 2x or 3x
  - So, theoretically, if the price of an index goes up 1%, then the price of the 2x leveraged ETF tracking that index would go up 2%
- Leveraged ETFs are generally used purely as trading vehicles due to the concept of price decay
- Leveraged ETFs carry greater volatility, thus greater risk

Leveraged ETFs – Examples

- (FAS) – Direxion Daily Financial Bull 3X Shares
  - Leveraged ETF that corresponds to 3x the performance of the Russell 1000 Financial Services Index

Inverse ETFs

- Inverse ETFs move in the opposite direction as the underlying index, commodity or basket of stocks
- Inverse ETF’s are generally used as trading vehicles because of the concept of price decay
- Some traders prefer to go long inverse ETFs rather than sell-short regular ETFs or futures
- There are also leveraged inverse ETFs that multiply the inverse returns of an index, commodity or basket of stocks

Leveraged ETFs – Examples

- (SDS) – ProShares UltraShort S&P 500 ETF (inverse)
  - A leveraged inverse ETF that corresponds to 2x the inverse of the daily performance of the S&P 500

Material Covered in Trading 101

- What a stock is
- How stocks are categorized
- The differences between investing and trading
- Being long vs. short
- Bonds, Options, Futures, Forex & ETFs
- How stocks are analyzed– Fundamental and Technical Analysis
- Different types of orders
- How to choose an online broker
- Different types of brokerage accounts
- How to mitigate risk
- Psychology of trading

Conditional Orders

Conditional Orders

- What is a conditional order?
  - A type of order that will automatically be submitted or cancelled only if another order is executed first
  - A type of order that allows you to PRE-PROGRAM your entry and exit strategies

Conditional Orders

- Why are conditional orders so valuable to investors?
  - By allowing you to pre-program your entry and exit strategies, they make it easy for traders and investors to lock in gains, limit losses, and automatically execute your trading plan – *even when you're away from your computer*
  - They eliminate the time-consuming and costly process of manually monitoring and adjusting trade orders due to specific events or investment strategies
    - Allow for customization of orders to meet the specific needs of investors
  - They can help you become a more disciplined trader, less subject to emotional swings

Types of Conditional Orders

- One-Cancels-the-Other (OCO)
  - Two orders are live so that if either executes, the other is automatically cancelled
  - The most well-known type of OCO order is called a "Bracket Order"
    - A pair of two orders for the same title and direction
    - One sell order is to realize the profit and the second is to limit the loss
    - Example: You own 500 shares of Microsoft (MSFT) at $35. You set a bracket order to sell at $34 and $37. Whichever triggers first, the other one will automatically be cancelled

Types of Conditional Orders

- Contingent Orders
  - An order that triggers automatically when a condition you set for the stock, option, or index is met
  - Example: You own 500 shares of Microsoft (MSFT). You set a contingent order that says, “If the Dow Jones Industrial Average (Dow) falls below a certain level, then sell my shares of MSFT.”

Types of Conditional Orders

- Multi-Contingent Orders
  - A contingent order that triggers based on a combination of two trigger values
  - Example: You own 500 shares of Microsoft (MSFT). You set a multi-contingent order that says, "If MSFT trades under $35 and the Dow Jones Industrial Average falls below a certain level, then sell my shares of MSFT."

Types of Conditional Orders

- One-Triggers-the-Other (OTO order)
  - An order that creates both a primary and secondary order. If the primary order executes, the secondary order automatically triggers.
  - Example: Microsoft (MSFT) is currently trading at $35 and you own no stock. You set an OTO order: 1) the primary order directs our online broker to buy 500 shares of MSFT if it reaches $35.50, and 2) if that order is executed, immediately put in a secondary order that directs your online broker to sell your MSFT shares if they trade under $34.50