Chapter 17

DAY TRADE VS POSITION TRADE

For years, the arguments have gone up and back: which is better, day trading or position trading?

We have heard many day traders say they prefer day trading because that way they leave less money lying on the table. They bemoan the plight of the poor position trader who is unable to extricate himself from a bad trade as quickly as can the day trader. They are of the opinion that they are able to extract profits quickly, while they are available. They enjoy the thrill of daily combat in the market place. Day traders also are of the opinion that they have more opportunities than do position traders. Finally, and importantly, day traders feel comfortable in not holding any positions overnight, and therefore are able to sleep without fear that they will awaken to some horrible unexpected gap in prices that will wipe out any profits that may have accrued, and which could result in a huge loss.

Of course, position traders hold just the opposite view. They feel that it is the day trader who is leaving the most money lying on the table. They feel that day trading erodes their capital base with excessive transaction costs. They pity the day trader who has to fight his way into a trending market numerous times throughout the day, often getting badly beaten up for his trouble, whereas they, the position traders, get to take advantage of the longer term trend. Position traders are not burdened with sitting in front of a screen throughout the day. They would rather be free to enjoy other aspects of life, and avoid the frantic trading often required of day traders. Position traders contend that with so many choices from which to choose, there is no lack of opportunity for entering well-thought out, well-planned trades. Finally, position traders take great comfort in knowing that when a market truly begins to trend and yields huge rewards relative to risk, that they will be in the market and will not miss the move.

Who is right? They are both right, or they are both wrong. It depends upon your point of view and where you are most comfortable.

The choice of time interval in which to trade is a function of comfort level: economic comfort level, emotional comfort level, or psychological comfort level, maybe all three. It is also a function of financial capability and trading acumen.

It is the knowledgeable trader who makes the most money. The trader who knows himself, knows how to read a chart, and is knowledgeable about the inner workings of the markets makes the most money, but even then, only if his knowledge is accompanied by disciplined action, disciplined decision making, and sufficient capital to comfortably support his style of trading and the time frame in which he attempts to trade.

Sometimes a combination of both day trading and position trading is in order.

Combining the two may be a good strategy for the position trader attempting to optimize his entries to and exits from the market by day trading an intraday chart at the specific times of entry and exit.

Combining the two may be a good strategy for the day trader who determines to hold a winning position overnight in those situations where a protective stop loss is able to be moved to where it is a profit protecting position.

Each trader will have to give up something in order to gain a feature enjoyed by the other. For example, the day trader will have to give up not holding overnight and miss being able to enjoy the benefits of the longer term trend.

The position trader, provided he has the time and ability to monitor the market during the day, will have to acquiesce to being tied to a screen for whatever amount of time it takes to day trade his entries and exits in an attempt to optimize them. If unable to watch during the day, it will be rather difficult to optimize entries and exits.

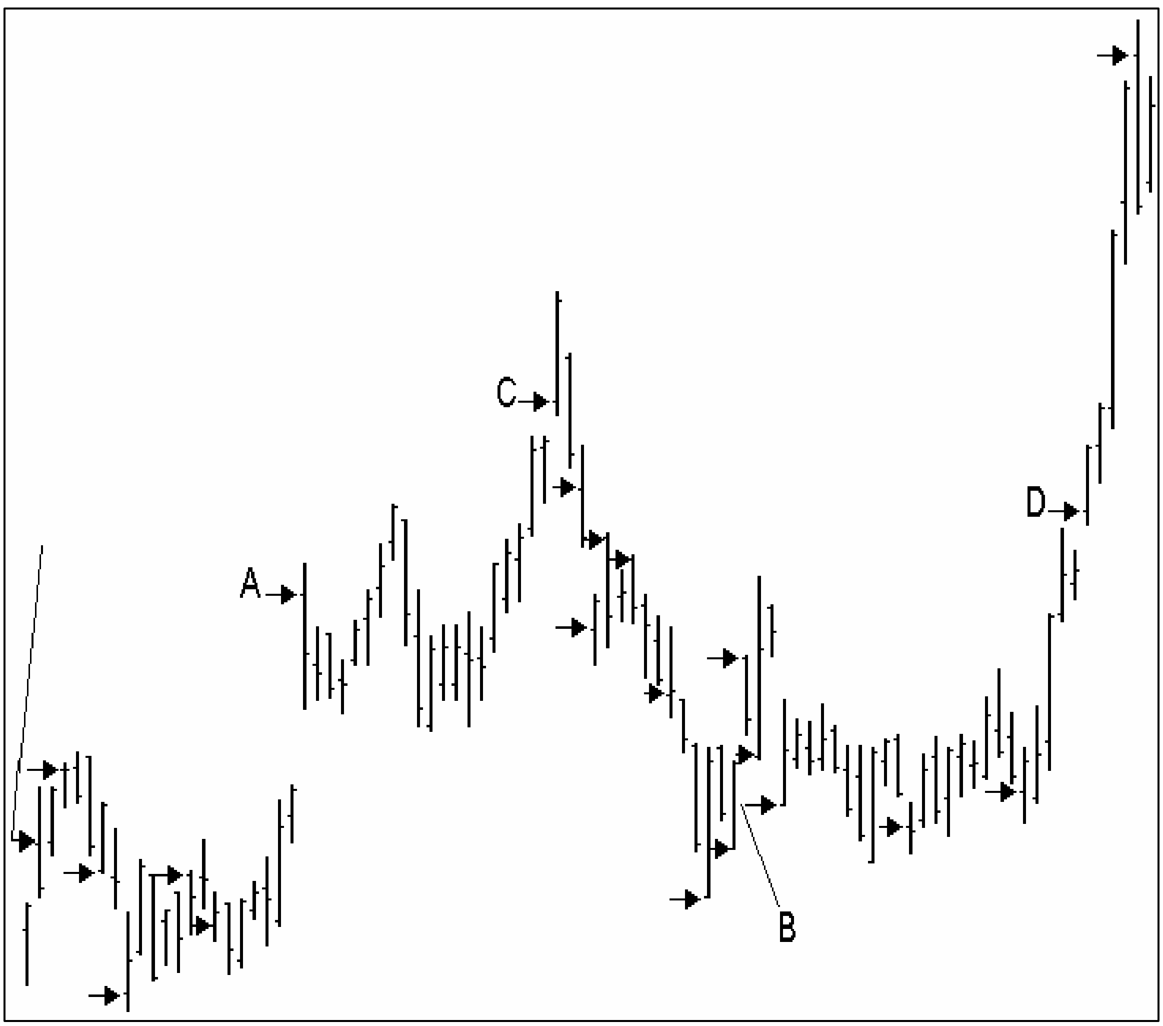
Let's take a look at each of these propositions to see how such a trading philosophy might work out.

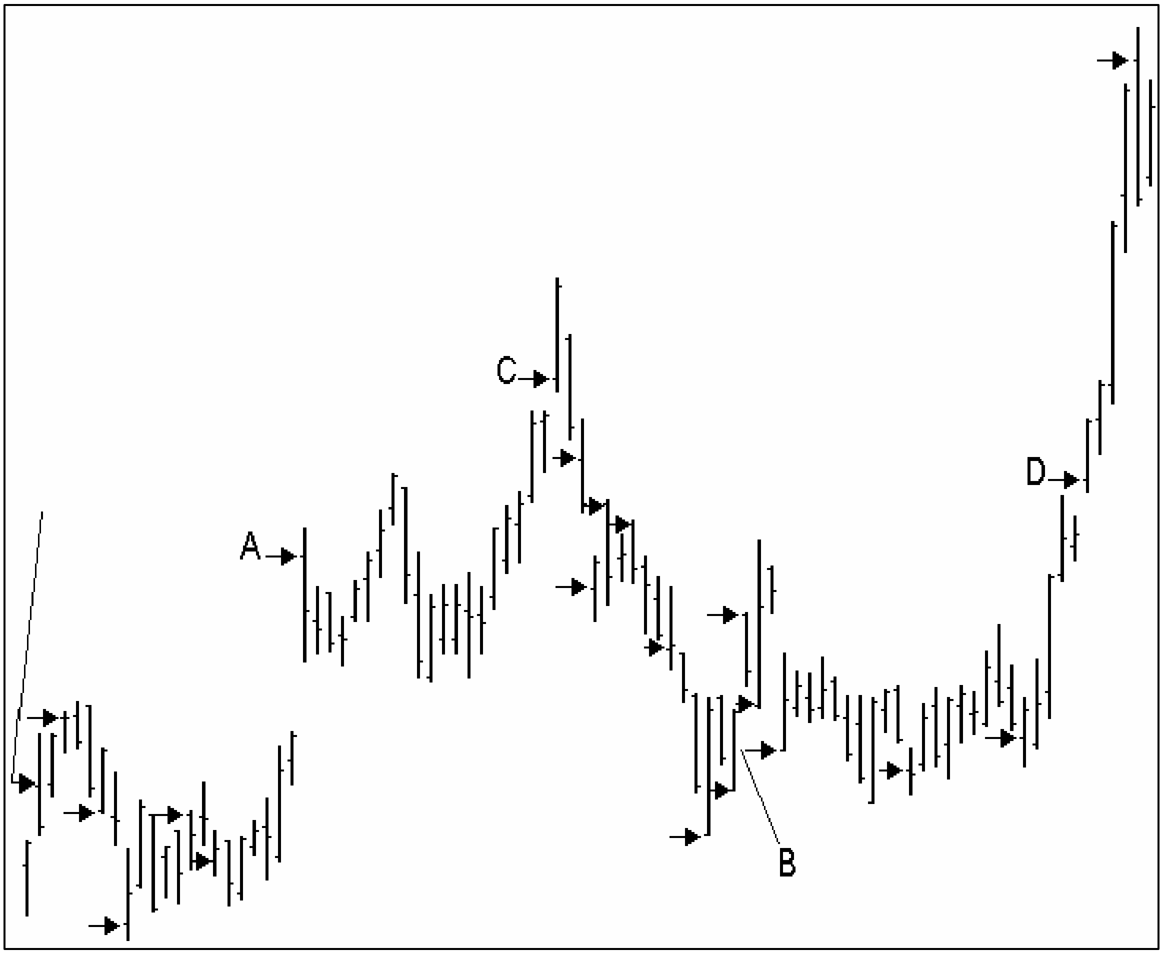
IMPLICATIONS OF DAY TRADING FOR THE POSITION TRADER

If a position trader has access to live data, and the free time to monitor the price action at such times as he wishes to enter or exit the market, he can often optimize the results of those events by engaging in a bit of day trading. Let's look at one situation in which this might be done.

Let's assume that the position trader is seeking either entry or exit on a day where prices open with a huge gap within or immediately outside of a congestion area.

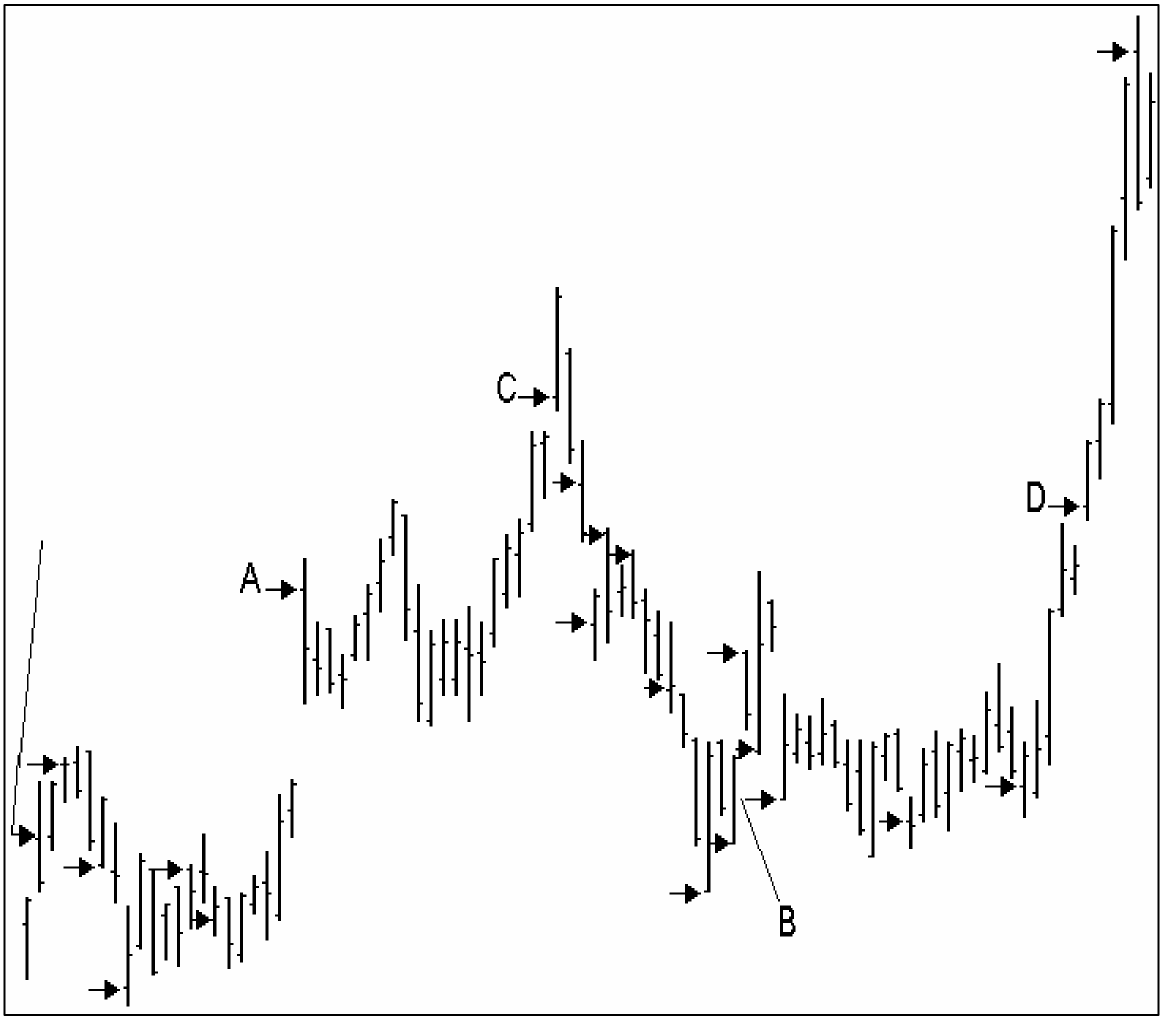
The percentages favor a reaction of some sort back towards the previous day's close. Usually, such a reaction will take place on the day of the gap. Occasionally the reaction will be delayed by a day.





On the chart above, we have taken the liberty of marking gap openings. There are a lot of lessons we can learn from this chart and we will use it again later. The first lesson to be learned provides the proof that gap openings within or immediately outside of congestion areas will usually result in a reaction wherein prices move back towards the previous day's close. This one piece of knowledge is worth many times the price of most books and manuscripts you are likely to have to pay for.

Now, let's look at the chart with respect to some probable positions held by a position trader. By day trading, the position trader can take advantage of that knowledge in light of the following scenarios:

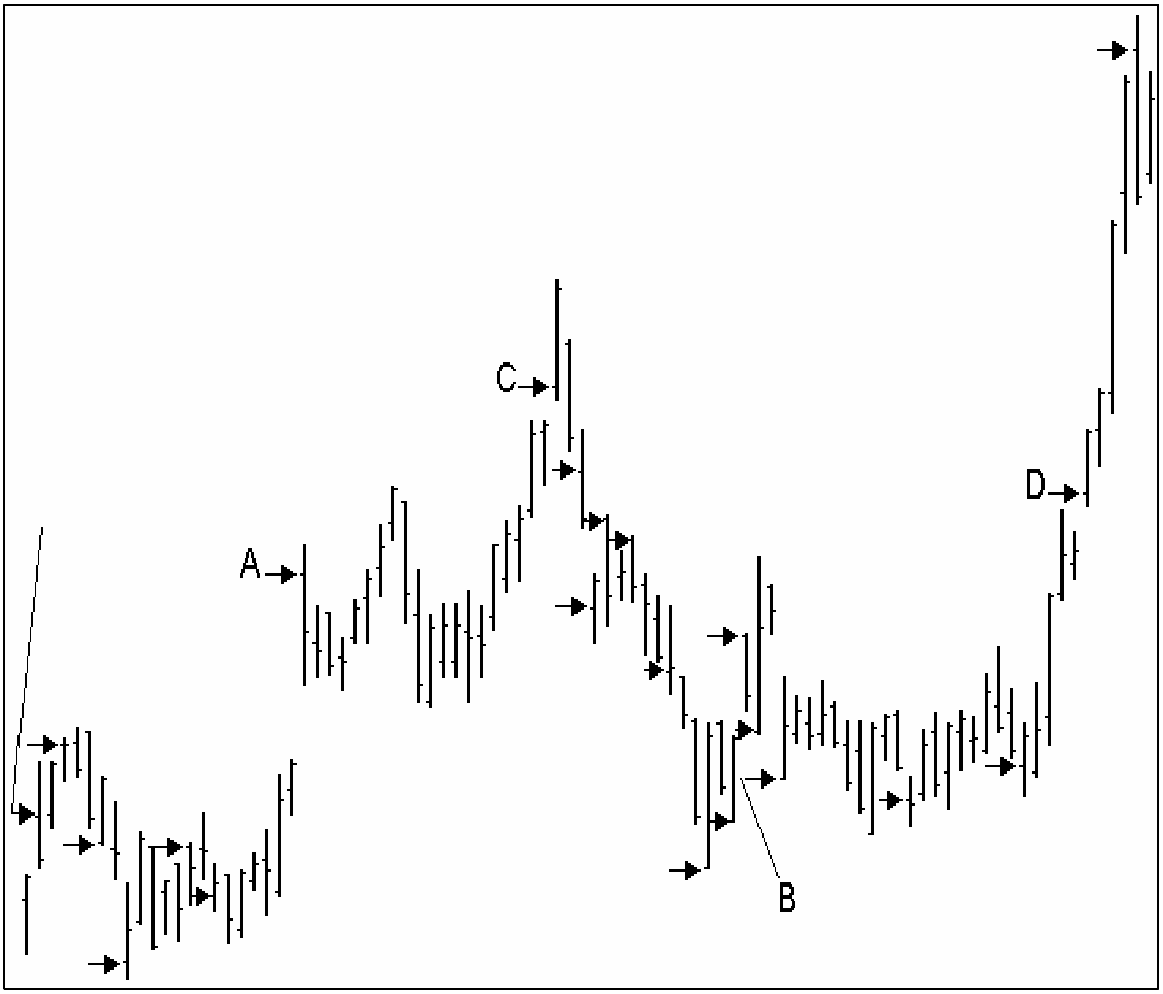


SCENARIO: THE GAP IS FAVORABLE AT "A" OR "B"

Knowing that most gap openings within or immediately outside of congestion result in a reaction with prices moving back towards the previous day's close, the position trader willing to day trade and desiring to reap the profits available from the reality of the gap, can exit immediately upon seeing the gap.

SCENARIO: THE GAP IS UNFAVORABLE AT "A" OR "B"

Knowing that most gap openings within or immediately outside of congestion result in a reaction with prices moving back towards the previous day's close, the position trader desiring to extract the most profits possible will wait for the reaction to the gap, and attempt to exit at a more favorable price than he might have otherwise obtained.



PERTINENT POINTS

- Notice that only at "**C**" and "**D**" is there a failure for prices to materially trade back toward the previous day's close. In the case of "C", prices reacted strongly on the following day.

- There are twenty-two gap openings marked on the chart. Only two of twenty-two failed to react strongly to the gap opening. One can say that 90.9% of the time, based on the price action shown, prices will demonstrate a strong reaction to a gap opening.

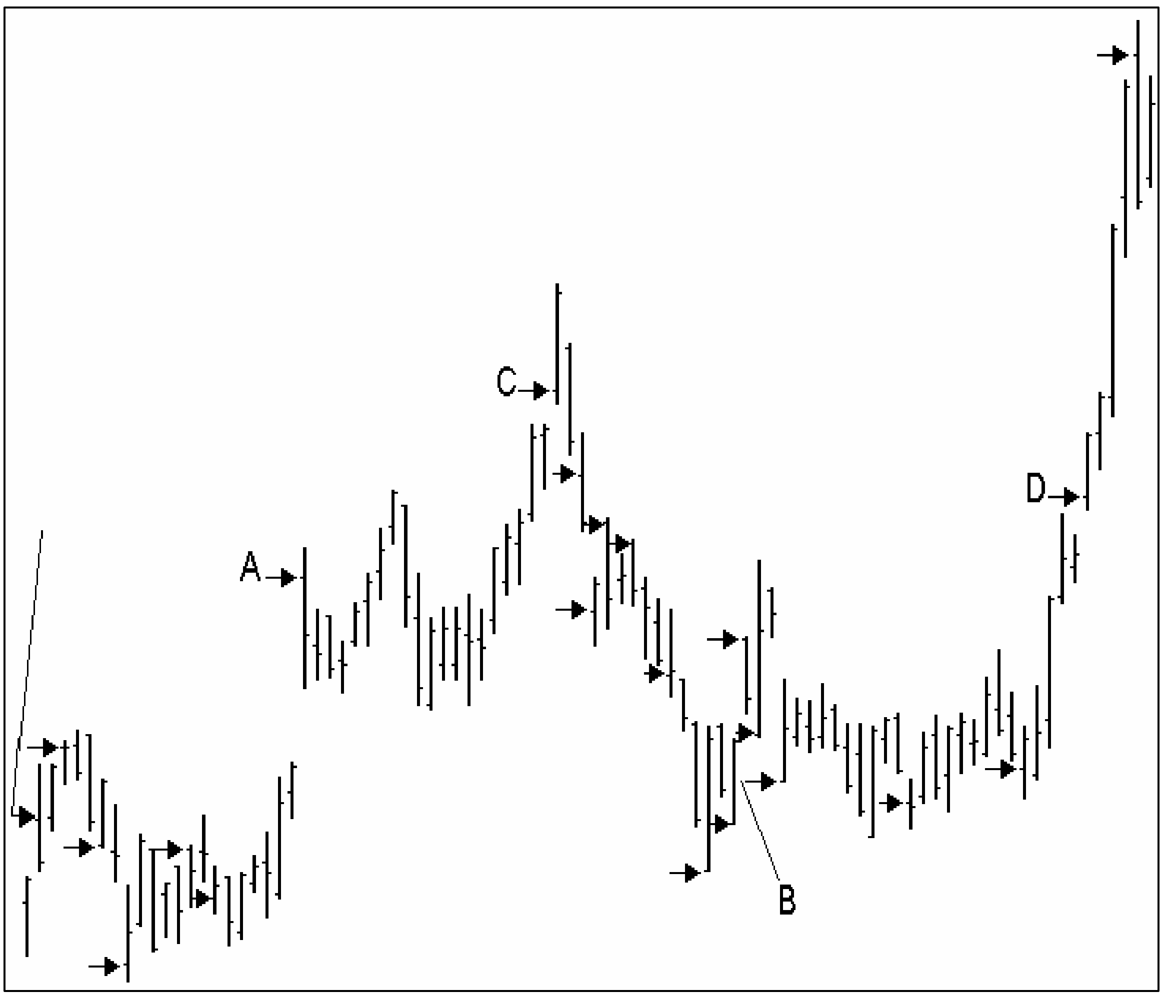
Implications of position trading for the day trader:

If a day trader is willing to hold overnight when his trade has accumulated acceptable profits, the day trader can often benefit by doing so when prices are strongly trending.

The trader must have seen sufficient profits in the trade by the time of the close to be able to place a profit protecting stop in the market.

The percentages of a trend continuing once it is strongly trending are very high, and definitely favor holding overnight.

Viewing the same chart of daily prices, we see that once prices began to trend at “D,” it would have been quite profitable to have held a winning position overnight as long as that position was protected by a stop.



PERTINENT POINTS

- Be sure that prices are truly trending. An acceptable trend is one that is moving at an angle of 45 degree or greater. Quite often, falling prices will exhibit a greater than 45 degree angle, especially at the beginning. Overall, prices tend to fall 1/3rd faster than they rise.

- Realize that there will be some sort of reaction to every gap opening. Do not let that panic you out of a trade. Decide beforehand exactly how much of your profits you want to protect, and stick with your plan.

- Occasionally, prices may jump over your protective stop, possibly resulting in a losing trade from what was once a winning trade.

- When a trend becomes too steep, and the trend line becomes parabolic, you are near the end of the trend. Tighten stops considerably, or consider exiting entirely.