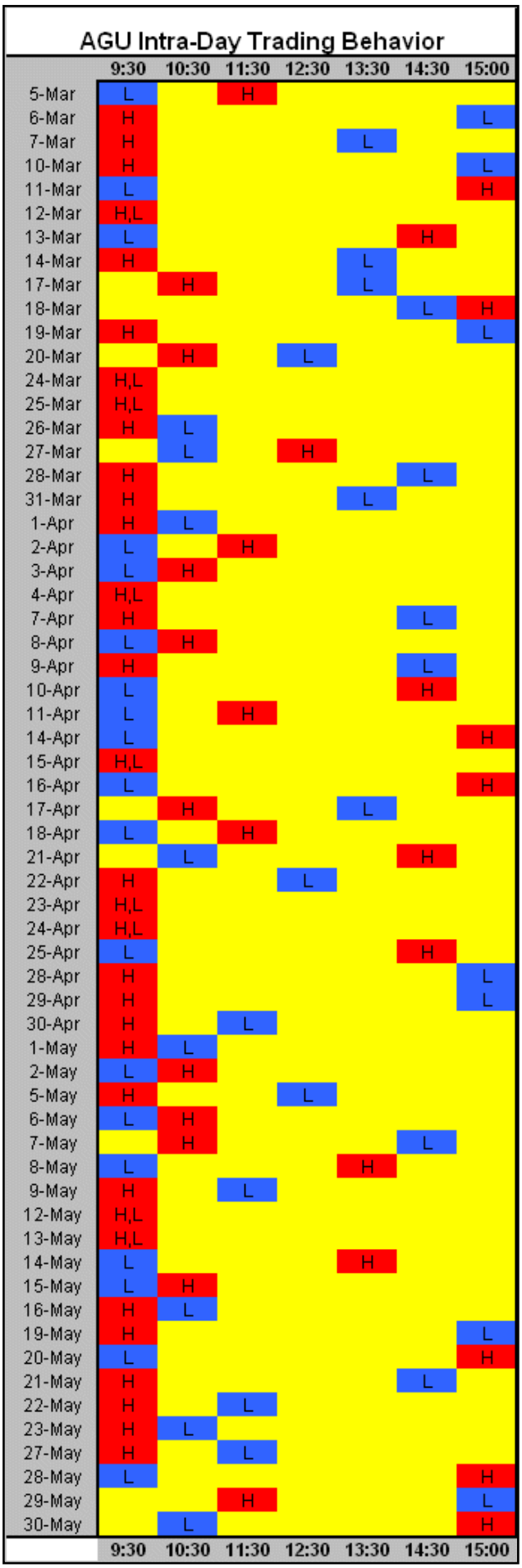
Trading Intra-Day is All About Finding an Edge (May 2008)

Trading intra-day is exactly what it sounds like. It's sitting in front of a computer during the trading day and making a lot of trades for small gains. Clearly it's not for everyone. For me, it means taking a $100,000 account and trading 500 to 1,000 shares of a $100 to $200 stock for 20 to 40 cent gains ($180 t0 $360 profit after commission). Ideally, I'll make 10 to 20 of these during the trading day, and that's a $1,800 to $3,600 (1.8 to 3.6 percent) return daily on a $100,000 account (and there are ~220 trading days each year). That assumes, of course, each one is successful for a 20 cent gain. My approach has been to find as many edges as I can so that my success rate is high, say 80 to 90 percent of the time. Let's talk here about these edges. Note, many are specific to the stock I'm trading, while others will others are more general

Fundamentally Sound Companies

Like the TripleScreenMethod daily stock trade forecasts, the TSM intra-day approach only trades stocks from fundamentally sound companies, *i.e.,* those high-volume stocks found in the TSM weekly screens. The reason is the same reason I concentrate on these type-stocks over longer time frames: institutions are buying them too, and their buying pressure supports price at obvious support zones: major moving averages, prior areas of price reversal, and Fibonacci levels to name a few. ***Trade fundamentally sound companies, that's trading edge # 1.***



Trading a Few Companies

The approach I favor is to identify a few companies, no more than five and getting to know them really well: study their intra-day trading patterns, understand how they trade around earnings and dividend reports, etc.

For example, the first chart focuses on the intra-day hour that AGU's high and low of the day were made over a five day period. The table to the left expands that look from 3/5/08 to 5/30/08. Eighty-five percent of the 61 trading days shown made either the high or low of the day in the first hour of trading.

Obviously, if I can identify whether the first hour is likely to be the high of the day (gaps up), I might sell my holdings and then try to re-buy them lower during the day. On the other hand, if I suspect it's a low (gaps down), I might buy and look to sell later in the day. ***This intra-day pattern of highs and lows is trading edge # 2.***

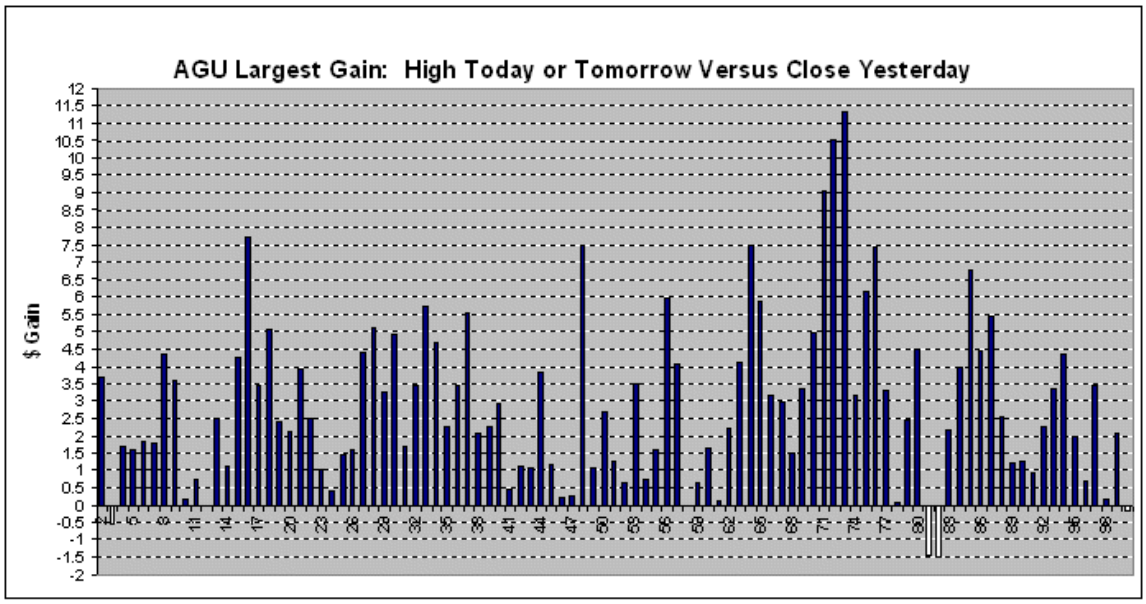
This pattern, too, reinforces the idea that the best time to day trade the market, *i.e.*, to be in front of your computer screen, is the first and last hours of the trading day.

Relationships Among the High, the Low and the Close

The relation between today's close and tomorrow's high and low provides another potential edge. High-priced stocks often tend to trade intra-day over a wider range than they do inter-day or between days. Often there's a consistent pattern of highs that are at least $1 higher than the previous day's close. As explained above, the high or low of the day is frequently made in the first hour of trading so often opening gaps are filled, *e.g.,* the high of the day occurs then reverses above the open.

From 1/02/08 through 5/27/08 (100 trading days), there were 82 AGU highs that made at least a 25 cent gain over the prior day's close; 77 at least 50 cents; 68 at least $1.00; and 59 at least $1.50. The average gain (today's high minus yesterday's close) was $1.94, and only nine were negative (five less than $1 below the prior close and four less than $1.50).

The chart below shows a slightly different distribution. Here, we're looking at the high made today and yesterday versus the close of the day before. Again, the gains are obvious: only five were negative and all less than $1.50. Do you think that a strategy that bought the close and sold for a dollar gain oven the next two days would be profitable, especially in a bullish market? I do too***. Inter-day relationships provide trading edge # 3.***



Candidates to Trade

To this point, I'm trading $100 plus, fundamentally sound companies because they trade over a greater daily range and have better institutional support. I'm limiting my self to trading five at any one time because I want to get to know their patterns intimately, as each can be slightly different. Examples today might include AAPL, POT, AGU, MON, IBM and MOS.

This group must meet a few other requirements as well: (1) trade at least two million shares daily (I'm looking for liquidity), (2) average an intra-day trading range of at least $2.5 (I'm looking for intra-day opportunity) and (3) average trading over a 15 cent or greater range each minute (again, intra-day opportunity). Additionally, it would be nice if its sector (and business industry) was under accumulation, but it's imperative that the stock itself is under accumulation, *i.e.,* more volume is trading at the "ask" (buyers driving the trade) than at the "bid" (sellers driving the trade). I expect to see volume increases on up days and On Balance Volume steadily climbing. Find further discussion of stock accumulation and distribution at the following link:

http://stockcharts.com/school/doku.php?id=chart_school:technical_indicators:accumulation_distribution_line

Trading liquid stocks undergoing accumulation provides trading edge # 4.

Intra-Day Areas of Support and Resistance

In addition to major areas of past price reversal (former peaks and valleys occurring days, weeks, months and even years earlier) that provide expected areas of major support and resistance, there are three others important intra-day that you should be aware of: the prior day's close, first hour's high and low trading close, and various intra-day Fibonacci levels. Examples of all three are shown in this next AAPL chart.

For the moment don't dwell on the other features, we'll talk about those in the next section. Just realize that one can use these potential areas of support and resistance to predict what price is likely to do when it nears one of them. ***Anticipating price reversal at areas of support and resistance provides trading edge # 5.***

AAPL
15-Apr-2008
© StockCharts.com
Open 149.40 High 149.72 Low 145.72 Close 148.38 Volume 24.9M Chg +0.60 (+0.41%)
High of Day
1 min) 148.38
MA(8) 148.08
Volume 323.98K, EMA(60) 71.47K
1st Hour's High Close
Resistance from 1st Hour's Low Close and Previous Day's Close
Prior Day's Close
1st Hour's Low Close
Support from 1st Hour's Low Close and Previous Day's Close
50% Pullback "Fib Level"
CCI Minimum then Trading "Wiggles" Over the Next Three Hours
62% Pullback "Fib Level"
Low of Day
CCI(70) 81.23
15Apr
10:00
10:30
11:00
11:30
12:00
12:30
1:00
1:30
2:00
2:30
3:00
3:30

Commodity Channel Index (CCI): The Degree to Which a Stock is Oversold

First, What is the Commodity Channel Index (CCI)?

As a refresher, $CCI_{14} = [(TP - \langle TP \rangle_{14}) / \langle TP \rangle_{MD}] \times 66.7$ where TP (typical price) = (High + Low + Close)/3; $\langle TP \rangle_{14}$ is its 14-period (1 min, 5 min or 1 day) moving average; $\langle TP \rangle_{MD}$ is TP's mean deviation defined as $\Sigma\ (abs(TP_i - \langle TP \rangle_{14})) / 14$ (from i=1 to 14). So what do all these numbers mean? Or more specifically, what do CCI_{14} values of -100, of -150 and of -200 mean?

$CCI_{14} = -100$ means $TP = \langle TP \rangle_{14} - 1.5\langle TP \rangle_{MD}$ or the current TP lies at its 14-period average TP minus 1.5 mean deviations (a measure of variability)

$CCI_{14} = -150$ means $TP = \langle TP \rangle_{14} - 2.25\langle TP \rangle_{MD}$

$CCI_{14} = -200$ means $TP = \langle TP \rangle_{14} - 3.00\langle TP \rangle_{MD}$

Suffice it to say that these measures are statistically relevant, as CCI_{14} grows more and more negative or the current TP becomes increasingly less than its average value. It's like a stretched rubber band that gets increasingly unlikely to extend further. Instead, it's far more likely to snap back. Therefore, CCI is an excellent indicator of when a market is abnormally stretched to its downside. Note, I use the 14-period CCI here for illustration. On a 1-minute chart, I use the 70-period CCI (5 x 14 that's used for 5-minute chart).

Consider again the AAPL chart, in particular the two areas with vertical green bars. These regions mark areas where CCI has fallen well below its -100 limit (dark valleys at the bottom of the chart), and the rubber band is stretched to its limit. Notice how price snapped back soon after: the first for about a half an hour and the second for over three hours. During periods of post CCI extreme minima, the edge is to the long side so I try to trade in and out as many times as I can after that state has been reached. I call it trading the "Wiggles." ***CCI minima identify oversold conditions that can be traded to the long side; hence, they provide trading edge # 6.***

POT (Potash Corp. Saskatch, Inc.) NYSE
©StockCharts.com
10-Apr-2008
Open 176.36 High 178.47 Low 173.25 Close 178.10 Volume 6.7M Chg +2.21 (+1.26%)
POT (1 min) 178.10
MA(8) 177.93
Volume 56.10K, EMA(60) 19,459
+1,353 in 9 Trades
Prior Day's Close
14:30 500 shs +$240
10:34 100 shs +$55
10:27 700 shs +$147
10:18 700 shs +$168
10:17 700 shs +$147
10:15 700 shs +$147
10:13 700 shs +$112
10:03 500 shs +$110
10:00 600 shs +$90
9:55 500 shs +$230
+1,593 in 10 Trades of 6,400 shs ($1,118,933)
CCI(70) 28.94
10Apr
10:00
10:30
11:00
11:30
12:00
12:30
1:00
1:30
2:00
2:30
3:00
3:30

Executing the TSM Day Trade

So far, you've identified the five stocks that you want to trade intra-day. You've used the TSM site and possibly Excel and the historical data generated at the Yahoo link: http://finance.yahoo.com/q/hp?s=POT to find patterns (relation of highs and lows to prior day's close, the timing of highs and lows of the day). You've set up a one-minute per candle chart with a 70 period CCI to identify significant minima. Now you're watching and waiting for the CCI minima to occur. Note, you'll learn that these are more likely to occur at certain periods of the day. When a minimum occurs and a clear bottom is formed (a candle closes higher than the high of the prior candle), you can begin to trade the "Wiggles."

POT's chart presents an example. On this day, two CCI_{70} minima formed. I made nine trades in 40 minutes to net $1,353. At the second opportunity, one trade (net $240) was made. In total, 10 trades and $1,593 net, 6,400 shares were traded (total value $1,118,933) to net $1,593 (1.3% on $125,000 trading account). For a large part of the day, you're doing other things and just occasionally glancing at the chart as CCI minima take time to form.

The next to last point that I'll make in this section is the issue of a stop loss. Because these stocks are expensive with quite a range of intra-day volatility, they can go against you quickly so a stop-loss strategy is a must, or you'll find yourself hanging on to a stock (admittedly a quality stock) as it pullbacks and then lamenting: "AAPL's a good stock, it'll come back." Most times they do, but occasionally they don't. Dell computer, for example, was the best performing stock in the '90s. It returned 72,818 percent over a 120 month period between Jan '90 and Dec '99. Then it pulled back and over the next 55 months (between Jan '00 and July '04) returned a -20 percent. It happens to the best of companies so it can happen to the one you're day trading as well. Use stop-loss strategies.

The stop-loss strategy that I prefer uses a 8-period (8-minute) moving average. I take a loss when I'm in a "Wiggle" trade and its one-minute candle closes below its 8-minute moving average. Get out, no question, take the loss and look for another opportunity. The following chart of MOS shows an example. The top arrow identifies an area where price, following a run up after the CCI minimum, has closed below its 8-minute moving average. Time to exit and watch for another opportunity.

MOS 1-minute Bar Chart
(5/2/08)
Stay in trade until
entire bar trades
below moving average
Trade "Wiggles"
Buy (500 to 1,000 shares) near
the moving average
and sell for a 25 cent gain.
Sell 1st bar when entire bar closes
above the 8-period moving average
Enter @ CCI minimum followed
by close above prior bar high
11:00
11:30
12:00
CCI minima shows
MOS significantlly
oversold (like a
stretched rugger band)
and ready to go
higher.

Finally, let's talk a little bit about market health and trading intra-day. First, you realize that if the market's trending down, you'll have to trade long with the wind at your face, so to speak. When I trade intra-day, I monitor two breadth indicators: the NYSE Ticks value and the NYSE Trin value. Let's finish this chapter by talking about each in turn.

The NYSE Tick indicator is simply a count of the number of NYSE stocks trading up in their last trade minus the number trading down. Any time it's positive, the market is bullish overall, as more NYSE stocks are trading up than trading down. By charting the Tick, either in the same time frame you're trading or longer, you can easily identify daily max/min points, areas where the chart is likely to reverse (support and resistance points). Ideally, before I trade the next "Wiggle" I would like the Tick indicator to be positive though not at its highs. Then, the wind is at my back.

For example, if the Tick reads +100, then 100 more stocks on the NYSE are ticking up then are ticking down. This is obviously a bullish signal. Conversely, if the Tick reads -100, then 100 more stocks are ticking down then are ticking up. This is a bearish signal. Watch it on a 5 or 15 minute chart in real time.

The Trin is another breadth oscillator which aids in the characterization of internal market strength or weakness. Called the "Arms Index" after its developer Richard Arms, Trin measures volatility within the stock market. Trin shows the relationship between advancing and declining issues by measuring their volume flow. It's another short-term trading tool, and one that trades inversely to the Tick.

In contrast to the Tick, a rising Trin signals that the *Bears* are beginning to take control. Likewise, a falling Trin tells us that the *Bulls* are taking control of the direction of the market because a falling Trin shows us that more volume is flowing into advancing stocks than declining stocks. Here's its definition (again, I use it to characterize NYSE traded stocks):

$$\text{NYSE Trin} = \frac{[\#\text{ Advancing Stocks} / \text{Volume of Advancing Stocks}]}{[\#\text{ Declining Stocks} / \text{Volume of Declining Stocks}]}$$

Ideally, I need the NYSE Trin below 1.10 to have the wind at my back. A positive Tick and Trin below 1.0 puts the wind at your back and provides trading edge # 7.