

Brian's Trading Rules
9/5/07
Version 0.60

Table of Contents

Introduction	1
Stock Buying Rules	1
Entrance Rules	1
A few extras:.....	2
More extras:.....	2
Exit Rules	5
Trading Summary	5
Stock Selling / Shorting Rules.....	6
Sell signals on stocks you already own.....	6
Sell signals on stock you want to short sell or buy puts on:.....	6
A couple extras:	6
Option Rules.....	9
Keep a Trading Journal to Record Every Trade	9
Choose Option Trading Strategy to Match Your Expectations	9
Options Exit Rules	10
Bull Put Spread (Credit Spread).....	11
Directional Options (Debit).....	13
Money Management	13
Setting Stops.....	13
Choosing the Option	13
Time	13
Exit (selling)	14
Upside:	14
Downside:.....	14
Sideways:.....	14
Last Week of Options Expiration	14
Rules under consideration	15
"Old Rules...but Very Good Rules"	15
Trading Rules for Swing Trading	18
Dave Landry at TradingMarkets.com:	20

Trading Rules

Introduction

The more I trade, the more I realize that I need trading rules. The rule set up a pattern of predictable results. If you have good rules, you will have predictably good results, bad rules, bad results. If you have no rules, then you will have unpredictable results.

I am currently in the process of figuring you my trading rules. The rules will be updated and change as I learn more. The follow set of rules are just a snap shot in time and are by no means complete.

As I write down all these rules, I realize that there are perhaps too many. Overtime, I plan to boil down this list, just down to the set of rules that are useful to me.

Stock Buying Rules

1) Keep a Trading Journal to Record Every Trade

Before Placing A Trade: Record exit rules for cutting losses and taking profits, entry point, reason for entering the trade support and resistance levels, general market conditions, how you feel about the trade when you place it.

After Exiting A Trade: Record exit price, profit or loss amount, why you exited the trade, why the trade worked when you win, why it did not work when you lose, what you learned from the trade, how you felt when you exited the trade.

Perform a post-mortem analysis on my trades on a monthly, quarterly, and annual basis.

Analyze what worked and what did not work and write your conclusions in your trading journal.

2) Weekly chart, use weekly for quick look

Entrance Rules

Many people believe that the buy signals come from just the technical signals (trends and green arrows) however for a stock to really give a true buy signal we need to look at the fundamentals as well.

- 1) The stock should have a positive Investools phase 2 score. This means an F/E score of 3.25 or better and a Price Pattern of 2.50 or better.

Trading Rules

- 2) The stock should trade in an up trending industry. Sideways is ok for covered calls but never a down trending industry.
- 3) The stock should be showing 3 green arrows. These come from the 30 day moving average, MACD's and Stochastics
- 4) The stock should be in an uptrend
- 5) The stock can be in a sideways trend as long as the stock is showing an increase of volume.
- 6) Investools Phase 1 at least 5/0 or up to 5/4
- 7) Big chart big chart increasing
- 8) Risk to reward ratio should be 3:1

A few extras:

- 1) NEVER buy a stock in a downtrend - No one is good enough to guess the bottom of a stocks trend.
- 2) Don't buy a stock near its resistance level if it does not have an increase of volume.
- 3) Positive news and increasing volume are bonuses.
- 4) With the proper technique, it can be a simplified process to identify buy signals. Just follow the rules and do not try to out-think the markets.

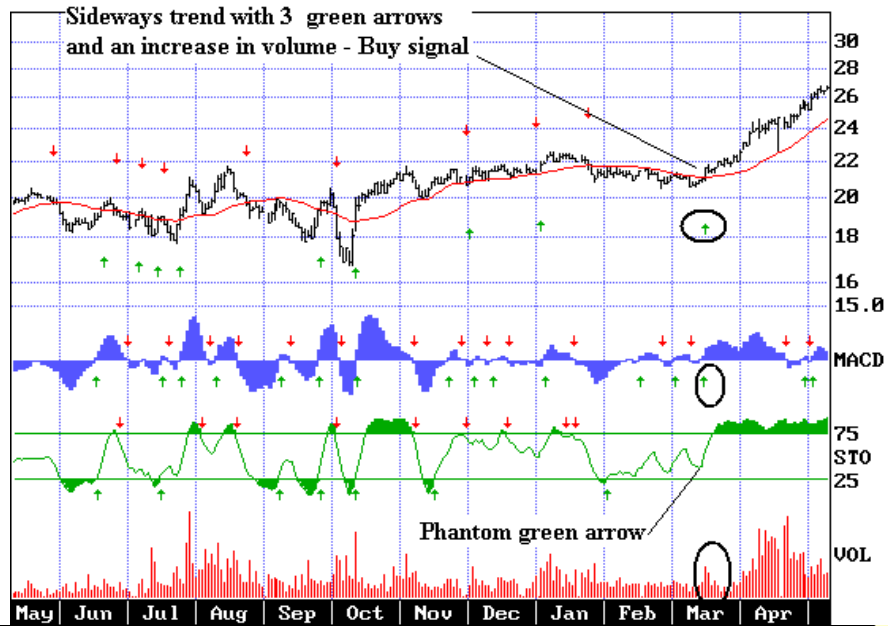
More extras:

Always have a stated target price and date in mind when buying a stock. Also have a stop price in mind. The difference between the current stock price and the target should be at least twice the difference between the current price and the stop price. This is referred to the upside / downside ratio. The upside / downside ratio should be greater than 2:1.

Trading Rules



Trading Rules



Exit Rules

- 1) If the stock does not behave as expected, then exit.
- 2) If the stock breaks the stop exit
- 3) If you have gained, 100% then sell 1/2.

Trading Summary

Check	Comment
Entrance Rules	
	The stock should have a positive phase 2 score. This means an F/E score of 3.25 or better and a Price Pattern of 2.50 or better.
	The stock should trade in an up trending industry. Sideways is ok for covered calls but never a down trending industry.
	The stock should be showing 3 green arrows. These come from the 30 day moving average, MACD's and Stochastics
	The stock should be in an uptrend
	The stock can be in a sideways trend as long as the stock is showing an increase of volume.
A few extras:	
	NEVER buy a stock in a downtrend - No one is good enough to guess the bottom of a stocks trend.
	volume.
	With the proper technique, it can be a simplified process to identify buy signals. Just follow the rules and do not try to out-think the markets.
More extras:	
	Is the upside / downside ratio greater than 2:1?

Stock Selling / Shorting Rules

There are two ways to look at sell signals, first is on stocks you already own and the second is on stocks you want to sell short or buy put options on.

Sell signals on stocks you already own – Any of these 4 will do:

- 1) The stock should have 3 red arrows or
- 2) The stock should have 3 red arrows and a broken support - This is the one I like to use
- 3) The stock has hit your target price - This is used to close out a trade
- 4) The stock has hit your stop loss price - This is used to close a trade that has moved against you

Sell signals on stock you want to short sell or buy puts on:

- 1) The stock should have a negative phase 2 score - F/E score of less than 2.50 as well as the Price Pattern score of less than 2.50.
- 2) The stock should trade in a down trending industry - Sideways is ok also but never an up trending industry.
- 3) The stock should be showing 3 red arrows. These come from the 30 day moving average, MACD's and Stochastics. If not 3 red arrows then the MACD's and Stochastics should no longer be moving higher (check these on a 3 month chart)
- 4) The stock should be in a down trend or if it is in a sideways trend it should be breaking through the support level on increasing volume.

A couple extras:

- 1) Don't sell a stock short or buy a put option on a stock near its support level if it does not have an increase of volume.
- 2) Bad news and heavy volume on down days are bonuses for selling a stock short or buying a put option on a stock.
- 3) With the proper technique, it can be a simplified process to identify sell signals. Just follow the rules and do not try to out-think the markets.

Trading Rules

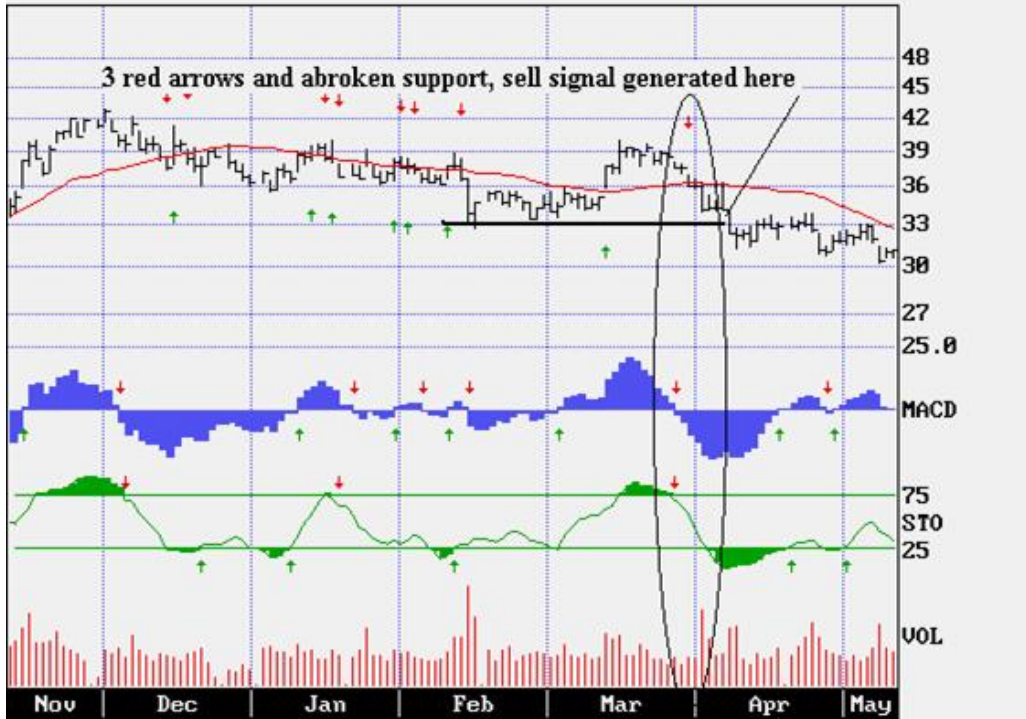


On the chart above, the stock was showing 3 red arrows as it dropped in value on a heavy volume spike.



On the chart above, the stock dropped beneath support on 3 red arrows and arrows and a volume spike. This generally shows institutional selling.

Trading Rules



Option Rules

Keep a Trading Journal to Record Every Trade

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After Exiting A Trade: Record exit price, profit or loss amount, why you exited the trade, why the trade worked when you win, why it did not work when you lose, what you learned from the trade, how you felt when you exited the trade.

Perform a post-mortem analysis on my trades on a monthly, quarterly, and annual basis.

Analyze what worked and what did not work and write your conclusions in your trading journal.

Choose Option Trading Strategy to Match Your Expectations

- 1) Bullish Strategies
 - a. Buy Call,
 - b. Bull Call Spread,
 - c. Bull Put Spread
 - d. Diagonal Call Spread.
- 2) Bearish Strategies
 - a. Buy Put
 - b. Bear Put Spread
 - c. Bear Call Spread
 - d. Diagonal Put Spread.
- 3) Neutral Strategies
 - a. Iron Condor (DJX or QQQ)
 - b. Calendar Spread
 - c. Strangle

Options Exit Rules

1. For Losses (or failed trades)

Always have a Stop-Loss set based on the minimum risk of these rules:

- A. Exit any trade that shows a loss of the predetermined risk level for that trade (Initially \$300)
 - B. Exit any trade when the stock price closes below (above) the lowest (highest) price in the last week.
2. For Profits (or to cut losses shorter)
 - A. Exit any trade when the initial entry signal is reversed.
 - B. Exit any trade that has not moved in my favor within two weeks.
 - C. Exit any trade when price closes below support (bullish trade) or above resistance (bearish trade)
 - D. Once a trade becomes profitable, adjust Stop-Loss in the direction of the trade.
Exit any trade when the stock closes below the Stop-Loss position.
 - E. Consider exiting 1/2 of your position when you have made a profit and the market pauses

Bull Put Spread (Credit Spread)

A Bull Put Spread has the following advantages:

1. Generate monthly cash flow
2. Limited risk
3. Ability to profit with small moves in the market
4. Short-term market outlook

Bull put spread is a credit spread; you buy a put option at one strike price and sell a more expensive one at a second price.

Trend

Determine Support and resistance

Know your risks

Always use money management rules

Short Time Frames

Avoid scheduled news.

Upwards

Stock should be the higher Strike price

Use the spreadsheet to calculate downside

Use spreadsheet for less than 2% risk

Since it's a credit spread, more time will allow a greater chance of the trade to go against you.

If earnings or such is announced, consider to defer the trade until after the news

Example:

Stock is trading 20.50

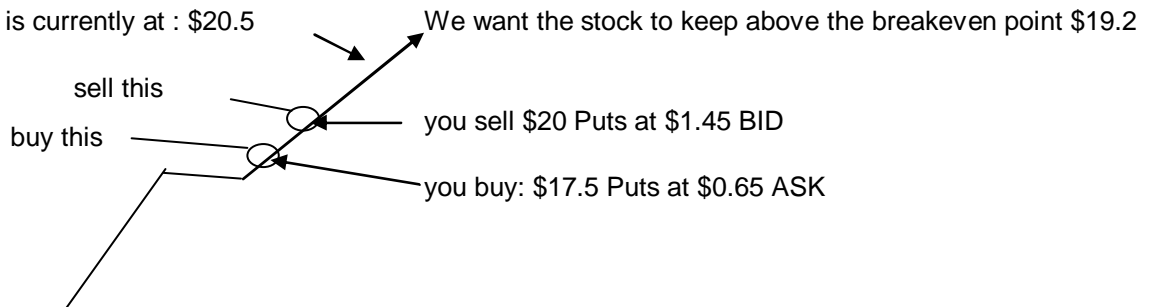
Buy the 20 Put at 1.45 BID

Sell the 17.5 Put at 0.65 ASK

Difference is 0.80 in your pocket

Calculated Breakeven is: 19.20

Stock is currently at : \$20.5



Trading Rules

Bull Put Spread Steps	Check List
1 Market posture should be bullish or netural)	
2 Pick an optionable stock to trade	
a Stock should fit our buying rules	
b 3 A's 2B's or better (phase 2 score)	
c in an uptreding industy	
d showing 3 green arrows in an uptrend or - 3 green arrows an heavy volume spike for a sideways trending stock bouncing off support with compelling reason	
3 sell put option at 1 strike price (bid)	
4 buy put option at lower strike price (ask)	
5 monitor your trade	
if stock moves higher - do nothing	
if stock moves sidewides - do nothing	
if stock drops slightly - do nothing	
if stock drops below Breakeven then close out	\$ 19.20
6 close out your trade only if necessary	

Directional Options (Debit)

Debit Directional Options are simply options that you purchase with the expectations that the stock price will move in a desired direction. If you expect the stock to move upwards, you buy calls, if you are expecting the stock price to drop, you buy puts.

I really need to be strong sense that the underlying stock is really going to move. With directional options, I will only make money if it's going to move. If I'm not positive about the move, then I will consider a spread trade.

The most I risk is the cost of the option. In other words, I can lose 100%. Therefore, it's critical to practice proper money management and to set your stops.

Money Management

Never risk more than 2% of an account on the trade. For an example if the account is \$100,000, then I never risk more than \$2,000. If using an account dedicated to just options, then I would consider 10% to 20%.

Setting Stops

Set your stops based on the type of options that I am trading. When I'm trading options that are expiring in a couple of months, I set the stops to at 50% of the current price of the option. If I'm using a long-term option as a stock substitute, then I will set my tolerance lower, perhaps 10% or 20%.

Choosing the Option

When trading for short term (3 months or less) I always use the options selection worksheet¹, Investools refers to this as the navigator. The worksheet determines whether it's better to buy stock or an option.

When trading long term or LEAPS I choose a strike with a delta of approx 0.75-0.85.

Time

Buy more time than you think you need. It will be more expensive, but you can sell it for more when you meet your target.

¹ Options Selection Worksheet: <http://xsprofits.com/Documents/option-worksheet.xls>

Exit (selling)

Upside:

If the stock hits the target price or 100% gain then sell 50% of the trade. For a LEAPS, if the delta gains to 0.95 or higher, then see if it makes sense to sell the option because the delta can't get much higher. It might make sense to buy a strike less in the money with a lower delta.

Downside:

If the stop is hit, sell.

Sideways:

Since we are buying time, if a shorter term trade has not moved in my favor within two weeks, then Exit

Last Week of Options Expiration

The option value is melting fast, sell it before the last week of expiration.

Rules under consideration

I've been collecting rules from other sources as well. I am currently reviewing and considering the following set into my own trading Rules

"Old Rules...but Very Good Rules"

If I've learned anything in my 17 years of trading, I've learned that the simple methods work best. Those who need to rely upon complex stochastics, linear weighted moving averages, smoothing techniques, Fibonacci numbers etc., usually find that they have so many things rolling around in their heads that they cannot make a rational decision. One technique says buy; another says sell. Another says sit tight while another says add to the trade. It sounds like a cliché, but simple methods work best.

- 1) The first and most important rule is - in bull markets, one is supposed to be long. This may sound obvious, but how many of us have sold the first rally in every bull market, saying that the market has moved too far, too fast. I have before, and I suspect I'll do it again at some point in the future. Thus, we've not enjoyed the profits that should have accrued to us for our initial bullish outlook, but have actually lost money while being short. In a bull market, one can only be long or on the sidelines. Remember, not having a position is a position.
- 2) Buy that which is showing strength - sell that which is showing weakness. The public continues to buy when prices have fallen. The professional buys because prices have rallied. This difference may not sound logical, but buying strength works. The rule of survival is not to "buy low, sell high", but to "buy higher and sell higher". Furthermore, when comparing various stocks within a group, buy only the strongest and sell the weakest.
- 3) When putting on a trade, enter it as if it has the potential to be the biggest trade of the year. Don't enter a trade until it has been well thought out, a campaign has been devised for adding to the trade, and contingency plans set for exiting the trade.
- 4) On minor corrections against the major trend, add to trades. In bull markets, add to the trade on minor corrections back into support levels. In bear markets, add on corrections into resistance. Use the 33-50% corrections level of the previous movement or the proper moving average as a first point in which to add.
- 5) Be patient. If a trade is missed, wait for a correction to occur before putting the trade on.
- 6) Be patient. Once a trade is put on, allow it time to develop and give it time to create the profits you expected.

Trading Rules

- 7) Be patient. The old adage that "you never go broke taking a profit" is maybe the most worthless piece of advice ever given. Taking small profits is the surest way to ultimate loss I can think of, for small profits are never allowed to develop into enormous profits. The real money in trading is made from the one, two or three large trades that develop each year. You must develop the ability to patiently stay with winning trades to allow them to develop into that sort of trade.
- 8) Be patient. Once a trade is put on, give it time to work; give it time to insulate itself from random noise; give it time for others to see the merit of what you saw earlier than they.
- 9) Be impatient. As always, small losses and quick losses are the best losses. It is not the loss of money that is important. Rather, it is the mental capital that is used up when you sit with a losing trade that is important.
- 10) Never, ever under any condition, add to a losing trade, or "average" into a position. If you are buying, then each new buy price must be higher than the previous buy price. If you are selling, then each new selling price must be lower. This rule is to be adhered to without question.
- 11) Do more of what is working for you, and less of what's not. Each day, look at the various positions you are holding, and try to add to the trade that has the most profit while subtracting from that trade that is either unprofitable or is showing the smallest profit. This is the basis of the old adage, "let your profits run."
- 12) Don't trade until the technicals and the fundamentals both agree. This rule makes pure technicians cringe. I don't care! I will not trade until I am sure that the simple technical rules I follow, and my fundamental analysis, are running in tandem. Then I can act with authority, and with certainty, and patiently sit tight.
- 13) When sharp losses in equity are experienced, take time off. Close all trades and stop trading for several days. The mind can play games with itself following sharp, quick losses. The urge "to get the money back" is extreme, and should not be given in to.
- 14) When trading well, trade somewhat larger. We all experience those incredible periods of time when all of our trades are profitable. When that happens, trade aggressively and trade larger. We must make our proverbial "hay" when the sun does shine.
- 15) When adding to a trade, add only 1/4 to 1/2 as much as currently held. That is, if you are holding 400 shares of a stock, at the next point at which to add, add no more than 100 or 200 shares. That moves the average price of your holdings less than half of the distance moved, thus allowing you to sit through 50% corrections without touching your average price.
- 16) Think like a guerrilla warrior. We wish to fight on the side of the market that is winning, not wasting our time and capital on futile efforts to gain fame by buying

Trading Rules

the lows or selling the highs of some market movement. Our duty is to earn profits by fighting alongside the winning forces. If neither side is winning, then we don't need to fight at all.

- 17) Markets form their tops in violence; markets form their lows in quiet conditions.
- 18) The final 10% of the time of a bull run will usually encompass 50% or more of the price movement. Thus, the first 50% of the price movement will take 90% of the time and will require the most backing and filling and will be far more difficult to trade than the last 50%.

There is no "genius" in these rules. They are common sense and nothing else, but as Voltaire said, "Common sense is uncommon." Trading is a common-sense business. When we trade contrary to common sense, we will lose. Perhaps not always, but enormously and eventually. Trade simply. Avoid complex methodologies concerning obscure technical systems and trade according to the major trends only.

Trading Rules for Swing Trading

These trading rules below should help your swing trading efforts yield more profits. By following some trading rules, your trading approach will be far superior to any trading method without rules. The objective for all of us is to maximize gains while minimizing losses along the way. Successful trading requires discipline, and these guidelines will help you in your quest for profitability.

1. Emotional control is at the heart of good trading.

Controlling yourself allows the ability to think clearly at each moment, resulting in success as a trader.

2. Cut losses with the most strict discipline.

We must preserve capital at all times. Losing is part of trading, but opportunity cost is to be considered when hoping for a losing position to reverse course. If your trade reverses and violates support, get out and be willing to re-enter. This will save you from big losses and you can always re-enter if the stock crosses the entry price again.

3. Make good decisions and winning will take care of itself.

Focus on how you play the game and not on the scoreboard. Trade with discipline and follow your game plan.

4. When you lose, don't lose the lesson!

Forget the names but remember the events. Those who don't remember the past are doomed to repeat it. Make mistakes with composure and character, without blaming others, and don't dwell on mistakes.

5. When in doubt, get out.

Scrutinize your positions at all times, each day, and you will not be left holding a stock without reason. Be willing to change direction at any time, because your flexibility as an individual investor is a big advantage which should be embraced!

6. Keep your risk/reward profile in check.

Profits can exceed losses even if the number of losing trades is greater than the number of winning trades. Always properly manage money, size positions accordingly, obey stops, and protect profits. This will keep you in the game!

7. Avoid scheduled news.

We are unable to foresee breaking news, but scheduled news we can step aside from. Scheduled news includes interest rate announcements, corporate earnings announcements, and various daily economic releases. Remember to trade only when you've got the best of conditions.

8. Consider your account size for appropriate trading.

Trading Rules

An account that is too small magnifies the effects of each trade, which keeps us from thinking rationally. Trade with the attitude that the next trade will simply be 1 of the next 1000 trades you will make.

9. Get a charting program that allows you to build watch lists, sort stocks, and draw trendlines.

This is essential to learning. Price action and volume are vitally important in finding good [chart patterns](#).

10. Scale out of winning positions as they work for you.

This achieves two goals: taking some off the table and keeping you in the game. If your trade reverses, you took some profit at good spots. If the move continues, you are still on board for the ride.

11. Don't dig yourself into a hole early in the day or in your career.

Be willing to observe the market and make an informed decision. Missed money is better than lost money, so wait patiently for the best opportunities to arrive.

12. Trade with a blend of anticipation and confirmation.

Balancing these two will mean that you adopt a system of "if this happens, I will do that." Wait for your pitch!

13. Beware of your trading process following a winning streak.

After a win streak, be extra disciplined! Many will make money in the market, but discipline is required to KEEP it. Stay on your guard at all times!

14. Evaluate your results at least monthly.

Monitor your P&L, your win/loss ratio, and the relationship between your biggest wins and worst losses. Reviewing these results helps you continually improve your understanding of the markets and yourself.

15. Finally (perhaps most important), always be patient.

Long-term patience will keep your confidence and optimism high, and short-term patience will help you wait for the best trades. Success doesn't come easy, and rarely are fortunes made overnight. Be willing to pay your dues and put in the work in order to achieve your goals.

Dave Landry at TradingMarkets.com:

1. Trade in a conceptually correct manner

Trading because Mars lines up with Venus might work occasionally, but there is no real basis for trading in this manner. Patterns you trade should make sense and have some sort of statistical edge.

2. Trade small

Any ONE trade should NOT have a material impact on your life. ANY one loss should be viewed as an “expense”—no different from what you do in any other business.

3. Ignore the news

The news is irrelevant. It's the reaction to the news that's relevant.

4. Forget about logic—Don't worry about the “whys”

Stocks trade on emotions--period. There often is no logic as to why a stock rises or falls.

5. Know YOUR Methodology

Each method will have its sweet spot.

6. Don't deal in mediocrity

Pick the best and leave the rest.

7. Do NOTHING unless there is something to do!

Your performance is based on the good trades less the bad trades. By avoiding the markets in less-than-ideal conditions, you'll have fewer bad trades hence, better performance!

8. Stack the odds in your favor: Market/Sector/Stock

Your odds will greatly improve if only trade when the market, sector, and stock are all trending in the same direction.

9. Let things work

Results in trading are often skewed---most of the gains come from a few big winners. Therefore, it's crucial to catch these occasional homeruns.

10. Money management

Trade small, use stops, take partial profits when offered, trail stops.

11. Money management

Trade small, use stops, take partial profits when offered, trail stops.

12. Money management

Trade small, use stops, take partial profits when offered, trail stops.

Trading Rules

- 1) Trade like a guerilla warrior. You must learn to adapt quickly to changes. If the winning side is changing, don't hesitate to join the new party and to commit all your forces to this side (capital ,mental, emotional)... until the market conditions change. Don't get married to trades.
- 2) Be disciplined Create a game plan then stick to it. A trade does not simply consist of a position. It consists of a position plus reasons for having the position plus a stop loss level plus profit taking levels. In the long run your discipline will save you when markets get rough.
- 3) Buy high -> Sell higher - Sell Low -> Buy Lower. Do not try to bottom fish or pick tops. When you think you know the trend then follow it.
- 4) Think big picture but trade like a technical analyst. You must understand the fundamentals behind your investment ideas but you need to understand the Technical Analysis too. When your fundamental and technical signals point to the same direction... you have a good chance to have a winning trade.
- 5) Do not use excessively tight stop losses. Spend more time identifying a good entry point. Be patient. Give some freedom to the market. Place your stop losses carefully.
- 6) Hit your stops. The first stop is the cheapest stop on a losing position. Do not follow the temptation to "hang onto" a losing position that has gone through your stop loss level. It might work a few times but one day you will be hammered if you trade without discipline.
- 7) In a Bull market... Be Long or Neutral - in a Bear market... Be Short or Neutral. A lot of people forget this rule and trade against the trend by calling for short term changes in market conditions. This usually causes psychological imbalance and frequently leads to losses.
- 8) Go for the most powerful market trend. Do not focus too much on markets where the trend is not strong enough or the market is range bound or choppy. Commit your forces to the stronger trend.
- 9) Accept losses they are part of the game. Prepare yourself mentally and emotionally for this eventuality. Take some time off and come back fresh if you have been hit hard. Do not fight with the trade, curse the market or make some bargain with yourself (... if the market goes to my initial level I will get out... !).
- 10) Resist the urge to trade against the trend too early. The trend is usually right (fundamentally). Be patient. Wait for the trend to turn. When the fundamentals and technicals are turning to the other direction, wait a bit longer then enter.

Trading Rules

- 11) Never add to a losing position. This is a recipe for disaster. Just add to winning positions especially when the market is retracing.
- 12) Do not make a winning position lose. Use trailing stop losses. You must learn to take profits.
- 13) Bear markets are more violent than bull markets. You can trade bear markets with smaller positions. Expect violent retracements so get in the habit of taking profits.
- 14) Keep all your technical analysis simple. Use simple support and resistance, Fibonacci retracement and reversal days. A good tip: When yesterday's daily trading range is the smallest of the previous last 11 days trading range...be ready for a big move and some volatility.
- 15) Be aware of market liquidity at all times. Assets do not just have prices. They have liquidity levels too, and just as prices change so too does liquidity. Illiquid assets do not trade in the same way as highly liquid assets. Only trade lower-liquidity assets if there is sufficient compensation for the lack of liquidity and you are a true expert in the asset class.
- 16) Be intellectually honest. When you are wrong admit it , learn from it and go on to the next trade. The market rewards intellectual arrogance with losses and pain. If you want to stick to your point of view no matter what the evidence may be to the contrary... become a politician.
- 17) Wall Street climbs on a wall of worry. Be aware that the most likely time for a bull market to end is when everyone is bullish and the bottom of a bear market occurs when everybody is bearish. When everyone is on the same bandwagon... be careful and get ready to get out.
- 18) Be aware of psychological biases in the markets. Bond traders tend to make most money as economies slow and dip into recession. Stock traders tend to make most money when the economy booms. So many bond market participants are always pessimistic and many stock analysts are perpetual optimists. Try to remain objective and observe which market commentators appear objective too.
- 19) Be patient. The more profound your ideas the longer it will take for others to see them as well and thus the longer it will take for markets to move your way. Be patient and give yourself and your trades time.
- 20) If you have to... break the rules!