The Basic Principle for Trading Stocks:

The Power and the Profit of the S-Curve

by

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I have a confession to make. I was in my early 50's before I traded my first stock.

After earning nearly one million dollars, by working in a variety of careers, I had little to show for it. I was upside down on my house and my car. I had more debt than I care to admit. And the only thing I knew about the stock market was the small amount I had stuck away in a 401K.

Sad, isn't it? After $1,000,000, you'd think I'd have something to show for it.

The reality, however, is that most of you reading this small book are in the same position as me, or you are headed in that same direction. Why? Because each of us failed to realize that our greatest asset was the cash flowing through our hands and into the pockets of everyone else. That cash, had we been able to stop it just for a little while before it left our hands, would have enabled us to create a stream of cash flow that would have provided for us handily. But, we didn't know. I didn't know. I kept working, paying the bills, and struggling to get the cash in hand so all of the required payments wouldn't be late.

When I first started trading stocks, I didn't know anything about Wall Street. NASDAQ, ask, bid, brokers, stop loss - these were words I had heard, but I didn't know their importance. So, I dug in. I wasn't interested in a long term "buy-and-hold" approach. That works fine for some people. But I wanted to create immediate cash flow. I needed extra money.

My education began with a simple realization: stock prices go up and stock prices go down. Now, this may not seem much of an epiphany for you. But I never realized exactly how much prices go up and go down. It's something called volatility. And some people think it's a bad thing. An individual stock might change between 2% and 20% in a single day! Such volatility can make you gray before you're old - unless you understand the patterns within that volatility and how the very thing that others fear can actually make you wealthy.

If you lay the letter "S" on its side, then you can see an example of a typical stock. It starts high, goes low, climbs again, and then falls again. Now, every stock doesn't do this every single day. And some stocks do it more often than others. But, the way I'm thinking here... why buy and hold a stock for weeks or years, only to see the price go up and down like this over and over again? Why not simply buy it at the low point and sell it at the high point, and do this over and over again?

Well, this is the basic idea behind trading stocks. Rather than guessing on which stocks are going to go up in price over years or even decades, I look at something called technical indicators. It's not all that technical, actually. But these indicators help guide me to the stocks that are getting ready to go up or down in price. Once I've spotted those stocks, I buy them. I hold them for 20 minutes. I hold them for 4 hours. It all depends on what the indicators tell me. But I buy them when the price is low and I sell them when the price is high and I stick the money back into my account.

That earned money is now added to my trading account, giving me more money than I had earlier. With more money to trade, I can buy more shares. I take a new stock and buy it at the bottom of the S-curve and sell it at the top of the S-curve. And I stick this money back into my account.

I repeat this process again and again. The longer I can hold onto this earned money and trade with this higher amount, the more money I am able to earn. Eventually, however, I take some money out and pay a few bills. And then I go and repeat the process again.

Now, if the idea of making money out of money seems like a good idea to you, then I'd encourage you to keep reading. I'll answer some of your questions and address some of the doubts that are already running through your mind.

But first, I want to tell you about a certain type of stock that I focus upon. It's called a Gap. You see, one of the things I learned about trading stocks (the hard way), is that you must have a system for trading stocks. And you must find a strategy that's comfortable for you. I have a lot of profit with Gap stocks, so I have focused on them for the past year - studying thousands of gap stocks and trading hundreds of them.

In case you've never heard of a Gap stock, let me explain it. A Gap occurs whenever a stock opens at a price far lower than the previous day's closing price (this is called a gap down), or opens at a price far higher than the previous day's closing price (this is called a gap up). Of the stocks traded every day on Wall Street, these Gap stocks are some of the most volatile stocks traded. Therefore, I actually seek out these stocks each morning because I know that their volatility is fertile ground for making short-term cash.

Last time I checked, making money was the primary reason why anyone gets involved in buying and selling stocks. The difference is the time perspective and the amount of direct involvement you seek to have with that involvement. If you want to just write a check and have your money grouped together with tens of thousands of other investors, allowing someone else to make your investment decisions for you, and earning you less than 10 % annual interest on that money, then the lessons in this book are not for you.

But, some of you are willing to study and practice the art of trading stocks in the hopes of earning higher gains. This book will introduce you to some powerful information. In fact, it will teach you the central, most basic strategy of all stock investing, and give you the technical knowledge to make that strategy work for you.

People have different ways of earning money. Some people will go and spend a ton of money to buy a franchise or they will struggle to start a business. They will go through the hassle of hiring, training, and firing new employees. They will do all of this (and much more) to try and create a stream of cash to support their lives. Yet they know nothing about the simple power of the "S-curve" to multiply their wealth without employees or advertising or the start-up costs associated with any new venture. (I know this because I've started a few myself.)

So what is it? Fear? Low self-esteem? What keeps people from trading stocks and making money out of money?

Overall, most peole are simply ignorant of the stock market. Our limited knowledge of the stock market is wrapped up in 3 numbers and a letter - 401K. We put our money into the market and we hold and we hold and we hope that in the end we'll have enough for our retirement. We are told to be happy with annual ROI (Return on Investment) rates of 8% - that's a whole year to earn what can happen in just one week!

But some people are a little more adventurous. They think that making money in the stock market involves getting inside information about an up-and-coming new company. They might also believe that the stock market is like a giant dart board where it's either hit or miss. Still others believe it's like a large casino, where luck rules the day.

Well, I'm happy to inform you that none of these statements is true. I guess you could approach the stock market in that way. And you would end up being an outsider who never hits a bull's eye and who is very unlucky.

Rather than luck or inside information, what you need in order to trade stocks is a narrow focus. You could take one stock and trade that stock over and over, using the patterns I teach in this book to earn your daily living. I know people who do this. Or, you can learn a system that shows a repeating pattern among the technical indicators, and use that system to trade a more diverse group of stocks. This is what I do.

But, what you cannot do (if you want to make any money) is to trade stocks without a narrow focus and without a proven, repeatable pattern. You need a system that has a proven track record. And you need someone to teach you how to trade that repeatable pattern. Then you simply practice it until you know it well enough to make money at it. And the more you practice it, like anything else, the better (more profitable) you become at it.

Good luck finding a patient teacher. Your local broker is not going to give you tudoring lessons on how to trade in the stock market. Most of them don't even know the things that I've figured out on my own. They take the longer "buy-and-hold" approach. And, as I've said, that works fine for some folks. But "buy-and-hold" will never produce the kind of results that I have seen. And that's why the short-term play is my stock play of choice.

But enough of a preamble. I want to show you an example of the kind of stock play I like. It's called a Gap. As I said, this type of stock has been my focus now for quite some time. The reasons are many. But the primary reasons are two: (1) a Gap produces a repeatable pattern that we can recognize, and (2) a Gap is by nature a volatile stock with a high degree of same-day fluctuation. Put those together and we have a stock with a big movement in price that we can recognize as the "S-curve" and therefore we can profit when we buy it low and sell it high.

So let's go ahead and look at one now.

Chart # 1

The first thing I want you to see is the S-curve we've been discussing. If you turn this page sideways, then you'll see a series of curves that closely resemble the letter S. The S can be seen in the actual price of the stock and in the MACD indicator at the bottom of the chart. (No, it's not a perfectly shaped S. But, you get the idea. It has curves that fluctuate up and down, sort of like a roller-coaster. It has high points and it has low points.)

Let me explain what you are looking at. This chart shows the stock symbol STV (see the symbol in the upper left hand of the chart). The chart covers a six-day period in the life of this stock. The chart reads from left to right, so the date of 3-28-08 is the most recent date on the chart and it is shown on the far right column.

The chart is broken down further by five main horizontal blocks. On the top block, the price "candles" are shown. On the far right side of the chart, you can see the price of the stock. By aligning the candles with the prices, you can see that the price fluctuated from a low of 17.81 on the first day of the chart (far left column) to a high of 19.86 on the sixth day. That's a price change of 11 %. On the bottom right, you can see the time signatures when this price change occured.

Now, an 11 % ROI is pretty impressive over a six-day period in the stock market. If you had made this play, then you would have been pretty proud of yourself.

But, the fact is that over just the last four days of this stock, there were six obvious trading points. These six plays, had you traded them, would have netted you a ROI of over 30% during a four-day period.

What does this mean to you? Simple. If you had $3000 of your own money plus $3000 in a margin account at your broker, giving you a total of $6000 with which to trade, then you would have earned $1800 in four days.

And the funny thing is this - this pattern repeats itself day after day in the stock market. Based on the research I do each morning, these stocks come across my desk. I then wait for the patterns to develop and I buy low and I sell high. Or, as in the above example, I also sell high and buy low (more about this later).

It is almost this simple. Do the research. Recognize the pattern. Buy at the bottom of the "S-curve". Sell at the top of the "S-curve". Rinse and repeat.

The key question I have for you is this: is this something that is interesting to you? And I ask this for one obvious reason - everyone doesn't "get it". They don't see the potential or they simply are not interested. They'd rather do the grunt work that their particular job requires and then go home and "chill". They're not motivated toward making more money out of money. They are content. And that's okay.

But, for some of you, you get it. You see the potential. You recognize the pattern. And you want to know more.

For those who want to chill, just file this book away somewhere. If you ever get the urge to make more money, then pull it out and keep reading. Consider the fact that you only spent a few dollars to get a quick education on chart patterns.

But for those folks who see the pattern and want to know more, you are invited to keep reading.

Your first question, of course: "Is it always this easy?" No.

Second question: "Can you loose money?" Yes.

Any more questions?

You see, in order to become a successful trader, you need to get educated. You may not even have a brokerage account set up yet. Maybe you've never traded a stock in your life. You may not know the first thing about where to start. And if you just jump right in then you will probably lose your shirt. It would be kind of like giving a high school kid a hockey stick and sending him into the NHL. Yes, he knows how to swing the stick. He may even understand a few of the rules. But, without extensive training and coaching, he will get clobbered and never want to play the sport again.

The key thing is this: you must trade a repeatable pattern of a certain type of stock in order to increase your odds. You cannot just jump on every train that passes by. You have to be selective on the stocks you buy and when you buy them. But the good news is that you can figure this out. More than that, you can watch me trade these sorts of stocks. You can even copy my trades, do what I do, and make money by just copying my trades.

To me, it's kind of like learning to ride a bike. First, you see someone riding a bike and you think "Oh, that looks like fun. Look how fast you can go. I want the wind in my face too." And then you start with training wheels, four wheels instead of two, to give yourself a sense of balance along with the thrill of riding. Finally, you're ready to go it on your own - or, you're happy with a bicycle built for two because it makes you feel much safer or you just like the experience of trading with other people.

So this is my proposal. First you need an eduation. You will find the essential resouces for getting started in this short book. If you like what you see, and you are interested in learning how to use your cash to create more cash, then you might also read my first book, "The GapDownProfits System: How to Make Money in the Stock Market (Almost) Every Day of the Week". This first book gives a more thorough review of my trading strategy and is focused mainly on gap down stocks. (By the way, you can view all of my books at my storefront: http://stores.lulu.com/bjoiner.)

My goal is to help you make money out of money. There is this common idea that the daytrader must go it alone - the sort of lone ranger mentaility - and that you are in this new venture all by yourself. Now, I admire your commitment and your high self-esteem. But, the truth of the matter is that you're probably better off trading stocks with a group of like-minded people. That's why investment clubs sprang up like weeds many years ago. People need help determining which stocks to buy and when to sell them.

Establishing a group of like-minded traders, people who are looking at the same stocks and the same technical indicators together, like a team, and doing their best to make a profit - this represents the best chance for success. Although the individual trader must ultimately decide when to press the buy and sell buttons, I also believe that trading in a small group can be a significant learning experience, especially for those people who are just learning how to trade. So, if you are in a group now or you want to join such a group, then you can contact me regarding this idea.

Now, let's continue on to the meat of this book.

Before we begin to look at the S-curve and study the techinical indicators related to it, there are several things we need to cover. The following section is very dense. You may have to read it several times, looking back at the charts that follow, so that you can understand the material. Give yourself permission to do this. If this is new language to you, then it will take some time for you to understand it.

The Language of Trading Stocks

As with any new venture, there is a set of language that you need to be familiar with in order to work within that venture. Stock trading is no different. Most people are familiar with "bid" (the price someone is willing to pay for a stock) and "ask" (the price at which someone is willing to sell a stock). But we're going to cover some other terms now that you may not know.

Long & Short

One of the great things about S-curve trading is that it works with both rising prices and falling prices. You can make money when the price is going up. This is called a long trade. You buy when the price is low (the bottom of the S-curve) and you sell when the price is higher. You make a profit if the price is higher when you sell it than when you bought it.

You can also make money when the price is going down. This is called a short trade. In simple terms, by using your margin account at your broker, you borrow shares from your broker and sell them when the price is high (the top of the S-curve). Then you buy the shares back, when the price is lower, essentially giving back the borrowed shares to your broker. This is called "covering your short". You make a profit if the price went down after you shorted this stock and you covered your short at a lower price than when you bought it.

Candles

There are different methods for showing the price movement of a stock within a given time span. We will be using candles, a Japanese method for showing price movement. A five-minute green candle means the current price is higher now than it was when this five-minute period began. A red candle means the price is lower than it was when this five-minute period began. (It looks like a candle only in the sense that it is a vertically shaped rectangle, like a candle, and the height may vary from one candle to the next.)

A line coming out of the top of the candle is called a wick. A wick means the pirce was higher at one point during this time period than it is right now.

A line coming out of the bottom of the candle is called a shadow. A shadow means the price was lower at one point during this time period than it is right now.

Long wicks and shadows indicate a lot of price fluctuation in a stock without much certainty of direction. It shows mixed investor sentiment.

A solid candle, with little or no wick or shadow, means great certainty regarding the price direction of that stock. So, a solid green candle means a congruence of opinion regarding investor sentiment that the current price for this stock is a great buy. A solid red candle means investor sentiment is bearish, or negative, regarding the current price of this stock. This sentiment, however, can quickly change.

Shorter candles can indicate that investor sentiment may be ready to change directions.

Once you grasp this basic understanding of candles and how their appearance gives you information regarding investor sentiment, then you are better equiped to use them when watching, buying, and selling stocks.

MACD

MACD = Moving Average Convergence Divergence. Since it is an average, the MACD smoothes out the minute-by-minute fluctuations in price. It is a widely used technical indicator, which makes it a sort of self-fulfilling prophecy. By itself, however, it is not a predictor of price movement. It is a mathematical average of previous prices, not a predictor of future prices. For example, just because the MACD is falling in an S-curve formation does not mean the curve will necessarily turn up and regain its loss. It can simply fall and then go flat, for example. It can fall , flatten, and then fall some more. So, simply buying at the bottom of the MACD S-curve is no guarantee of success.

That being said, the MACD can help us see the bottom of a price trend and it can keep us from bailing out too soon on a rising issue.

News

News regarding the market, the economy, and this particular stock is important because it influences market sentiment. Market sentiment is totally reflected in the price of the stock and the direction of its price, as well as the price direction of the overall market.

However, it is important that you not assume the role of a prognosticator. Knowing the news and looking at the charts in the light of this news, and then making assumptions about how the market will respond to this news, are two different things. This is an important distinction.

We do not trade on hunches or guesses. We trade the charts. That is the wonderful thing about technical trading, once you understand it. We study the charts and determine when to buy and when to sell. We do not try to predict investor sentiment. We see that sentiment in the current price of the stock. So, we do not predict price movement based on the news. We simply observe the stock price in the light of this news. The news informs us but it does not carry equal weight with our other technical indicators. Remember, the market's response to the news may be different than what you had expected. The charts tell us what people really think about the news. The charts measure investor sentiment.

Stochastics

The Stochastic indicator measures whether a stock is over-sold or over-bought. (Don't worry about the techinical aspects of this.) If a stock is over-sold, then the price will be low because the bears are winning - investors who had held their shares are now selling these, causing the price to go down. Others are taking advantage of this downward trend and shorting the stock in order to make money as the price goes down. This puts even more pressure on the downward movement of the stock and thus it becomes over-sold.

At some point, however, bargain hunters move in and take advantage of the new low price. This drives the price up. Investors cover their shorts, driving the price higher. And daytraders get in on the act and go along for the ride. Eventually, the stock becomes over-sold and the reverse happens.

The point at which the over-sold line crosses over the over-bought line is a significant technical indicator. It reaffirms that the price direction is beginning to change. Demand is exceeding supply and therefore the price is going up (or vice-versa).

The Stochastic indicator can be set up as a %K line and a %D line, with variables of 6 and 5 respectively. When the %K crosses up and through the %D line, then the translation is that the stock is moving away from its over-sold position. As this occurs, we can expect a slight bump up in the price. But, by itself, it is not a buy or sell indicator. It is simply part of the whole picture that we study.

RSI

RSI = Relative Strength Indicator. In simple terms, RSI measures the strength of a stock in terms of price and volume. In a way, it is measuring muscle. How strong is this stock?

If the RSI of a stock is pointing down or riding the bottom of the chart (i.e. below a 30 index), then the price will probably continue to fall. If the RSI is pointing up (i.e. above a 60 index), then the price will probably continue to rise. But, this has to be looked at in relation to the other indicators we are studying. You cannot make a blanket statement that the price will definitely rise if the RSI is above 65.

The longer a rising RSI can be maintained, the more likely the price will continue to rise. A strong RSI is more influential on price than the Stochastic indicator. So, a falling Stochastic indicator may mean the price will fall only momentarily if the RSI is still providing strong fundamental support. A rising RSI is especially important when the price encounters the Bollinger Bands.

Bollinger Bands

Bollinger Bands are another widely used indicator. Basically, it combines two sets of moving averages in order to create a sort of moving, boundary average for a stock. Most charting services allow you to color between the lines and the result is a sort of highway of averages for the stock you are studying. These Bollinger Bands can be looked at from a daily chart perspective as well as a one-minute chart perspective, and everything in between. For my trading, I've added them to my 10-minute window.

The way to think of Bollinger Bands is that they provide a sort of comfort zone for the stock price. A stock that has fallen far below its Bollinger Bands faces some pressure to come back into a normal trading zone **if** everything else is normal (i.e. news related to the market, the economy, and this particular stock). A stock that is trading far above its Bollinger Bands will face pressure to come back to "normal".

I find the Bollinger Bands primarily relevent as it relates to RSI. A price that has leveled off at the bottom and is starting to head back up and into the Bollinger Bands requires enough RSI (muscle) to move through the Bollinger Bands and then fight its way back up to the top of that Bollinger Band. It's sort of like crossing a river with a fair amount of current: if you have the strength for it then you can do it. Without this RSI, the Bollinger Band becomes an inpenetrable wall and the price will stay below the bottom Bollinger Band as the price continues to descend.

However, a stock that has enough strength to enter the Bollinger Band stream and actually cause it to change course in an upward direction (due to the new moving averages) is a strong stock indeed and one worth buying.

Chaikin's Money Flow

You'll also see something at the bottom of these charts called Chaikin's Money Flow. It is a measurement of whether money is flowing into or out of a stock. Typically, I don't use this indicator for short term trades, except to determine the previous day's cash flow and how that relates to the current situation for this stock.

A Congruence of Opinion

Putting all of these indicators into a couple of charts on your trading window will give you multiple opinions about the strength and direction of the stock you are studying. I call this "a congruence of opinion" because we are not just looking at one indicator (i.e. the MACD) and trying to forecast the price direction of a particular stock. We are looking at Candles, News, Stockastics, RSI, MACD, and Bollinger Bands and we are trying to gain a sense of price direction. The great thing is this: if these sources are giving us mixed signals, then we do not buy or short this stock. We look for a stock where the research gives us a clear message to either buy or sell a particular stock.

There are other safeguards that help us keep our profits, and I will discuss these as we begin to look at exact buy and sell signals. But, before we could discuss those specific signals, you needed to understand the basic components of our charts. If you'd like more knowledge regarding any of these indicators, then there is plenty of material available to you. (You can also view my blog, where I list daily trades for you to analyze, at: http://gapdowntrades.blogspot.com.)

Chart Analysis

Now that you know some of the language of techinical trading, it's time to study the charts and apply what you have learned. The title of this short book is "The Power and the Profit of the S-curve", and I'm going to show you three types of daytrades, all related to the S-curve. By nature, a daytrade is a position that you enter and exit on the same day. You do not carry over any holdings from one day to the next. Each day presents a fresh start and many new opportunities. These three daytrade patterns are built around the S-curve format, using the technical indicators we've been studying together. You're getting ready to see just how powerful and profitable the S-curve can be when applied to daytrading.

I will call these three daytrades: bottom-S, top-S, and middle-S. The first one is a long trade, where you buy low and sell high. The second two are short trades, where you sell it high and buy it low (as described above under "Long & Short").

1) Bottom-S

The bottom-S trade involves finding the bottom of a gap-down stock, buying it as it shows signs of recovery, and then riding the recovery for the maximum possible profit.

Chart # 2, below, is a one-day overview of a gap-down stock that occured on April 1,2008.

Chart # 2

On the right half of the chart, you can see how the stock gapped down at the opening of the day. The long red candles show the strong downward pressure on the price of the stock and this is reflected in the MACD. (The red lines in the MACD, just above the MACD graph, are called histograms.) You can also see how the Stochastics kept falling, along with the RSI. Everything is pointing down as the price keeps below the Bollinger Bands, unable to muster the strength to challenge it.

But then what happens? Around 10:40, the candles turn green, the MACD graph creates a bottom, the red MACD histograms become shorter, the % K Stochastic crosses over the % D line, and the RSI begins to rise. This is the bottom of the S-curve.

Then what happens? All of the indicators begin to point upward. The green candles hesitate for a moment at the bottom of the Bollinger Band, and then begin to charge upward through those averages, as the other indicators support this movement. Around 12:10, the Stochastic dips a bit, indicating a temporary over-bought situation, but the RSI remains strong. The candles begin to hug the top of the Bollinger Band. And, eventually, the indicators begin to level out along with the price.

When you step back from the chart, you can see the S-curve, laying on its side, that I keep mentioning. It is a recognizable pattern. And the supporting evidence of the technical indicators shows a "congruence of opinion" that clearly says a "buy" was in order for this stock.

But how do you know exactly when to buy and when to sell?

Well, let's back up a minute and see how the chart looked in stages. Chart #3, below, shows a 10-minute confirmed bottom.

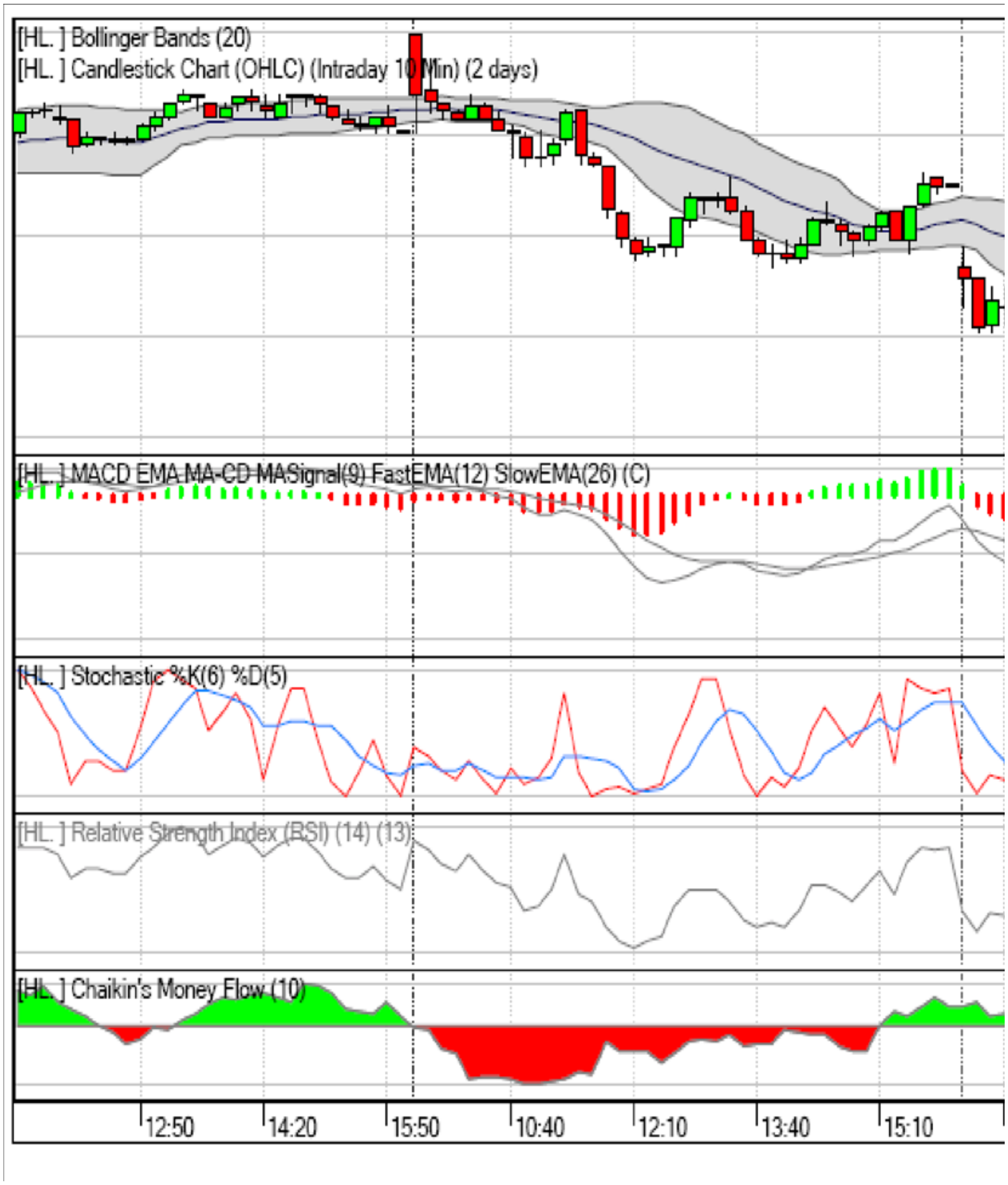

Chart # 3

You see the first signs of a recovery in Chart # 3. The MACD is forming its bottom. We have the first histogram that is shorter than the previous one. We have a strong green candle. And we have rising RSI and Stochastics. This chart is a 10-minute view.

The next chart, Chart # 4, shows the same stock from a 5-minute view.

Chart # 4

You can see the hook in the MACD and the green RSI line showing that RSI has risen dramatically so it is hitting 35% now. For me, that is a critical strength number. Putting all of this together, I have a clear reason to enter a buy on this stock at $10.57.

The next chart will show a view of this stock a short while later.

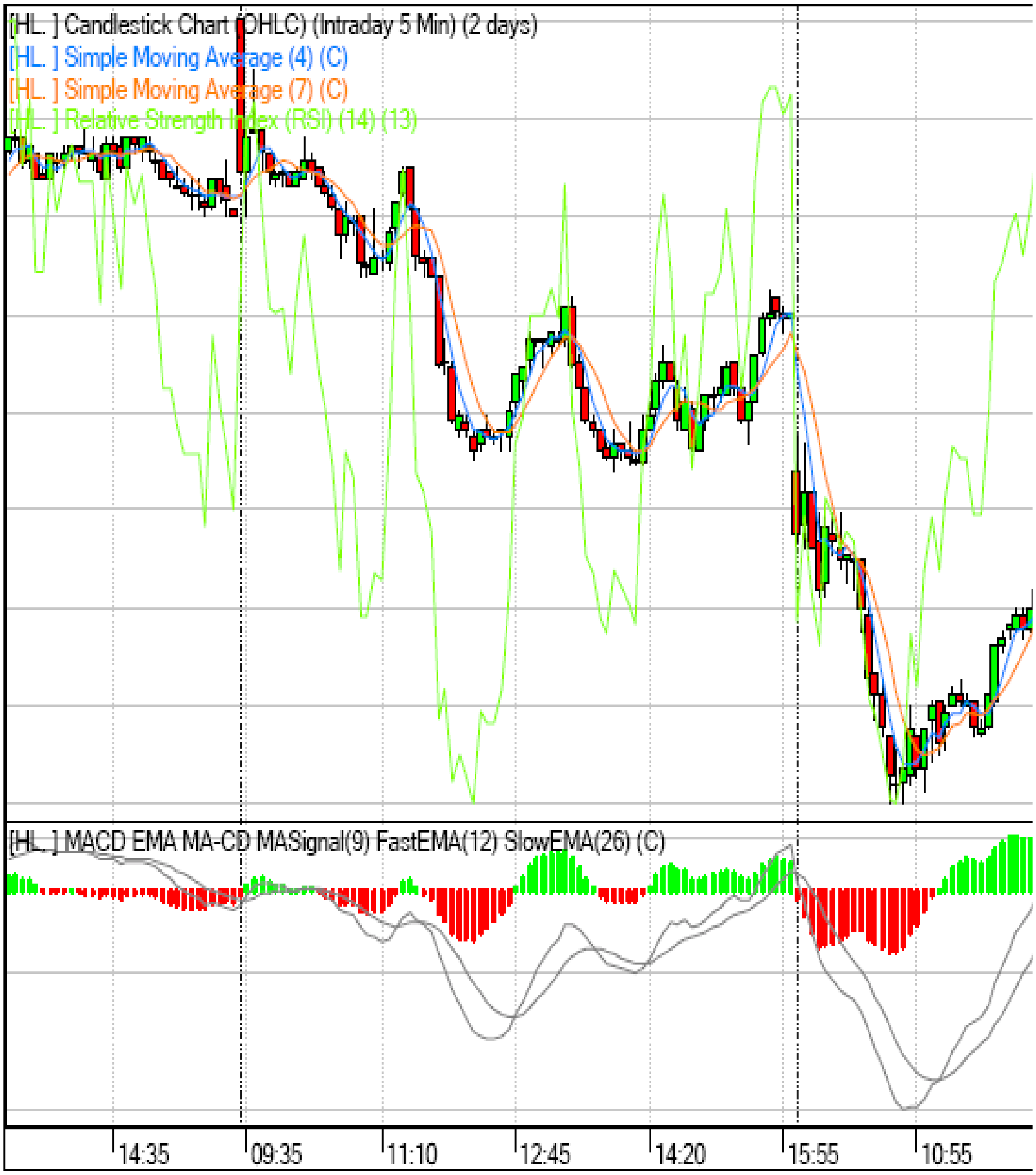

Chart # 5

The above chart shows how the RSI kept rising, along with the price. We have a widening divergence within the 5-minute MACD lines, and then a gradual curve as the price increase begins to slow. The other indicator I want you to notice on this chart is the blue line showing the 4 SMA. This is a 4-minute Simple Moving Average. See how the price hugs this average as it goes up. I'll show you another example of this in a minute. But, for now, just know that this is a key indicator that I am watching as I decide when to buy and when to sell.

Looking back at Chart # 2, you can see how the price ended up at $10.90. The sell point for me is when I am either satisfied with the profits, or the indicators tell me that the price is beginning to settle or possibly reverse. Important: I am not trying to reach the absolute lows and highs. So, a buy at $10.57 and a sell at $10.88 would have resulted in a 2.9 % ROI. That may not seem like very much to you. But, I purposely showed you a small price gain so that you would understand the power of the S-curve. At a 2.9 % daily ROI, how long would it take you to double your investment (especially if half of that investment was your broker's margin allowance)? If you had invested $3000 of your money and used $3000 of your broker's margin, then you would have earned $174 in about three hours. Obviously, the more you have invested, the more money you will make.

Now that you've seen an example of a modest price gain, I want to show you one that happened just as I was writing this book. The date is April 3, 2008. The stock symbol is MTRX.

Chart # 6

The stock had a 10-minute bottom at $15.97. You can see, from this end-of-day chart, the elongated S-curve. The indicators were never very low at the beginning of this chart, and that is the only sign that showed what a terrific play this might have been. The only news regarding this stock was the fact that the company had reissued its guidance for the near future, and had actually tightened their expectations. (Again, let the charts tell you the market sentiment regarding the news.)

The next chart looks at the same stock from a 5-minute perspective.

Chart # 7

On the 5-minute chart above, I have blocked out the area to show the buy point at $15.97 and the sell point at $19.26. The buy point comes right in line with the 10-minute bottom and an RSI of at least 35 %. What comes next is critical. Do you see how the price candles just ride right along the top of the 4 SMA (blue line)? Occassionally, the price dips down to the 7 SMA (orange line). But it's not until the line I've drawn that you get the 4 SMA crossing down over the 7 SMA. And that is your sell signal.

What's your total gain for one day? 21 % ROI in one day! Using the imaginary sum of $3000 plus $3000 in broker margin, you would have earned over $1200 in one afternoon by using only $3000 of your own money!

Now, I want you to sober up a minute and realize something. This sort of one-day gain is not typical. It is unusual. However, it does happen occassionally, and gains of 3 % to 5 % are more frequent.

Just imagine if you had $30,000 invested!

2) Top-S

The top-S trade occurs every day on nearly every stock that is traded. It happens when a stock has risen in price and then begins to retreat from that top price. It is the constant ebb and flow of stocks.

I particularly like gap-up stocks for this trade, however, because gap-up stocks are stocks that have risen early and rapidly in price. This rapid rise is price is often unmerited. And, since it is unmerited, the price will retreat at some point. If we can use the indicators to tell us when that price has peaked, then we can short the stock at that point and ride it down until it bottoms out.

It is important to use the indicators to tell us when this moment has happened. We may see a stock run up in price and think "this cannot continue" and short the stock too soon. We would then have a great deal of stress if that price continued to rise rapidly after we placed our short.

So, what are we looking for in a top-S trade? Basically, we want to see just the opposite of what we saw in the bottom-S trade. We are looking for a 10-minute MACD curve that has flattened out and even started to descend. We want to see falling RSI and a downward crossover pattern in the Stochastic indicator.

And we want to see the 4 SMA crossing down and through the 7 SMA.

Let's look at an example.

Chart # 8

Chart # 8 shows the stock WR on March 19, 2008. On the right side of this 2-day chart, you can see how the stock gapped up at the opening bell. But then what happened? It met price resistance three times in the first 30 minutes, never able to break out of the range of $23.70 to $23.97. This caused the MACD curve to flatten out. You can see how the over-bought situation quickly disintegrates in the Stochastic graph. And RSI just continues to fall with each new candle.

If you had shorted WR at $23.70 and then covered that short around 2:00 at $23.00 (when all of the indicators told you the bottom was over), then you would have made a 3 % ROI.

To give one more example of the top-S trade, let's look at Chart # 9.

Chart # 9

Although ALVR was not a typical gap-up, it nevertheless showed up on my screen as a brief gap-up. There was no hesitation in its collapse however. All of the technical indicators pointed down as soon as the market opened - showing that this was a good stock to short at the top of the S-curve. This was also a good stock to illustrate what I mentioned about Bollinger Bands. (You'll hear more about that in just a moment.)

One note here: you never know how far a stock is going to fall when you are trading the top-S. For that matter, you never know how any of your trades will perform. But, by learning how to read these technical indicators, you can get a pretty good idea about tops and bottoms. Just be sure and listen to the indicators and ignore your internal hope or desire for any given trade.

3) mid-S

The mid-S trade is another example of a short trade in the context of the S-curve. It actually happens in the diagonal line connecting the top-S to the bottom-S. And it also illustrates how we make corrections in our trading if one of our trades does not go as planned.

Let us say, for example, that we are looking at a gap-down stock and we see a 10-minute bottom beginning to form. It looks like a perfect bottom-S formation. We flip over to the 5-minute chart and we see a rising RSI of at least 35. So, we buy the stock long.

But then something happens. Perhaps the rest of the market gets some bad news. Or, perhaps, we bought a little prematurely. We watch as the price climbs 1 % and then we watch it quickly plummet by 2%. What do we do? Do we hold onto our position, thinking "it's got to turn around"?

Let's look at the example of BCSI that happened on April 4, 2008.

Chart # 10

You see the bottoming of the MACD. You see the Stochastic crossover. The RSI is beginning to point up. But then something happens. The next chart, Chart # 10, shows how the price went up to $20.74, and then it fell quickly.

Chart # 11

The RSI dropped quickly. The candles turned from green to red. And, in this image, you can see how the all important 4 SMA has just crossed down and through the 7 SMA - not a good sign. So, what do you do?

First, let's look at what happened from the 10-minute perspective.

Chart # 12

Do you remember what I said about the RSI in relation to the Bollinger Bands? If not, then go back and re-read it. This stock did not have enough muscle to cross the river. The price candles could not penetrate the bottom side of the Bollinger Bands. Whenever you see this, then you should immediately short the stock. If it's a stock you had bought long, then sell the long position and quickly short it. The reason: if a stock lacks the strength to pass through this Bollinger Band, then it is going to fall some more. In this case, you should have shorted the stock at $20.48, as shown in Chart # 10. Let's look at the stock later on and see what happened.

Chart # 13

You can see in Chart # 13 how the price kept falling, just beneath the 4 SMA. At $19.19, the stock appears to hit some resistance and the RSI is almost back at 35. So, this would have been a good point to take your profit by covering your short. Here's the same stock from the 10-minute perspective.

Chart # 14

In Chart # 14, I have blocked off the important indicators. From that bottom, you could have then reversed again and traded this stock long - now that all of the indicators are pointing up again. If you had shorted the stock at $20.48 and covered your short at $19.40, then you would have earned a 5.2 % ROI. Then you could have earned another 3.5 % ROI by reversing and going long on a new bottom-S trade.

Some Free Advice

I hope these three daytrade examples have illustrated the profit and the power of the S-curve. I want to make a few comments about how to apply what you have learned.

First, I never recommend that you use real money on a new stock strategy without first practicing this strategy. The best method for doing this is to set up your daytrading platform using the charts and the indicators that you see in this book. (If you want a more thorough lesson on how to do this, then download a copy of my book "The GapDownProfits System" at lulu.com.) If you are using ScottradeElite from Scottrade, then you can utilize their Virtual Trader to trade these strategies over and over again until you are averaging at least 2 % on every trade. Then you can start using real money.

Second, if you are new to stock trading then you need to enter this new profession with some caution. This is not a dart board where you glibly select a few stocks and wait and see what happens. You must have a game plan, a strategy for trading, and you must have the discipline to follow the game plan in order to eliminate risk and maximize your profit. Learning how to trade stocks through trial and error is a very expensive education.

Third, if you are new to daytrading, then make sure you understand all of the daytrading rules from your broker. For example, if you have less than $25,000 equity (your own cash) that you are trading, then you are limited to three daytrades per week. (In simple terms, a daytrade is entering and exiting the same stock in the same day.) Without $25,000 in equity, then you are limited to three daytrades for every five days that the market is open. This means that if you have less than $25,000 in equity, then you can only use the S-curve strategy three times per week, because these strategies are only to be used as same-day trades.

Fourth, cut your losses early. Do not be big-headed and think that every decision you make will go your way. (If it does, then you should write the next book.)

All of which brings me to an important issue: use moveable stops. "Moveable stops" is a phrase I made up. Going back to Chart # 6, for example, you could get a little nervous as this stock trades into the stratosphere. You might be tempted to get out at an 8 % gain. But then you would have missed the other 12 %. So, let me tell you one way to set stops. Stops, by the way, are automatic sell points that you can set up in your trading system. So, for example, if you set a stop of $20.00 on a stock and the price suddenly went south, then your shares would sell on/about $20.00 per share.

With a moveable stop, as your winning play continues to climb the charts, you set and reset your stops based on the movement of the stock. For example, on Chart # 6, as the price hit $17.00, you might move your stop to $16.50, thereby locking in some of your profit without selling any of your shares. At $18.50, you might move the stop up to $18.10, etc. Modifying your stops in this way, rather than setting an automatic 2 % Trailing Stop, for example, gives you more control over your stock, keeps you on top of what is happening with that stock, and allows you to precisly modify the stop based on what you see happening with the technical indicators. I think it's a pretty clever strategy and also instills some automatic discipline in the sell department, in case you are the type to get a little hyper-hopeful regarding your stock picking abilities. The key is not to set the moveable stops so close to the current price that you do not allow for the normal fluctuation that occurs in stock trading. Again, practice this before you begin using real money.

One final note...for those of you who might not realize the power of the gains I've illustrated in this book...a 2 % daily gain in the stock market is huge. The market average is somewhere around 8% per year! So, 2 % in one day is very big. Daily gains greater than 2 % are very possible by using the S-curve, once you know what you are doing. But let me translate that into a specific dollar amount for you. If you have $3000 in equity and you get $3000 of margin from your broker, then you have $6000 for trading. If you trade this strategy just three times per week (your limit under non-daytrading status) and make an average of 2 % per trade, and do not withdraw any money from that account, and trade each time with that new amount, then in one year you will have $124,181 instead of just $6000. At that point, you could start taking some money out because you would qualify to trade this strategy every day as a daytrader and you would be earning nearly $2500 per day in income. Not bad for starting off with just $3000.

I hope you have found this book enlightening. I hope you use it to make lots of money, which is my wish for you if that is your wish for yourself.

I am available for private coaching and group seminars/webinars - both on a limited basis. If you have any questions, or want to contact me, then please send an e-mail to bob@gapdownprofits.com.

Happy trading.

Robert C. Joiner
April 10, 2008

Book, blogs, and trading programs by Robert C. Joiner

The GapDownProfits Strategy: How to Make Money in the Stock Market (Almost) Every Day of the Week. Over 69 full-color charts are included in this step-by-step guide to trading gap down stocks. By far, this is the most profitable strategy I have ever traded.

I type a short blog (almost) every day giving one or two gap down trades that were profitable that day. This is great for practice and review, once you know the technical side of trading gap downs. View the blog at http://gapdowntrades.blogspot.com.

S.A.M.: The Performance-Based Stock & Asset Management Program. This is a short document that outlines a joint venture effort with other investors. Some people have neither the time nor the inclination to trade their own stocks. So, I trade their accounts for them, for a % of the profits. There is no up-front fee for managing the account, as with every other managed account out there (that charges you even when they lose your money).

Soon to be released:

The Top 12 Ways to Lose Money in the Stock Market and How to Prevent It From Happening to You. A huge percentage of traders are barely breaking even on their trading efforts. Much of this has to do with lack of strategy, allowing the losers to eat up their profits, and not mastering the inner game of trading. This book lists my top 12 picks and shows you how to stop the bleeding.

Gap Up - Gap Down: One Week of Trades. Using the basic strategy of the S-Curve and applying it to the parameters established in GapDownProfits book, I took one week of trades, printed them, and critiqued them. This is a great way to get lots of winning trades in front of you, so you can see how this pattern repeats itself every day in the Market. By knowing the footprint of successful trades, we learn to trade more profitably. Over 40 full-color charts are included.

All of my books are available at: http://stores.lulu.com/bjoiner.

You can also visit my website at: www.gapdownprofits.com.

Thanks for listening.