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THE AFTER HOURS TRADER

- HOW TO ANALYZE ECNs
- LEARN TO SIDESTEP COSTLY MISTAKES
- HOW TO PROFIT FROM AFTER-HOURS NEWS

MICHAEL SINCERE
& DERON WAGNER

The After-Hours Trader

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The After-Hours Trader

How to Make Money 24 Hours a Day Trading Stocks at Night

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Dedication

To Alexandra, Neringe, and Rachele

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PREFACE

We are delighted that we were given the chance to write about one of the most remarkable events in Wall Street history, the opening of the after-hours market to the individual investor. It is not often that you get an opportunity to write about something that you know is going to change history. But that's exactly how we felt over the last few months as we thoroughly researched and interviewed the people who are intimately involved in bringing after-hours trading to individual investors. In fact, we feel the same as the early Internet pioneers who knew they were involved in something that was destined to change the way the world does business. We strongly believe that after-hours trading will have a similar effect.

We wrote this book because we wanted to help you understand how the after-hours market works, what you need to do to get started, what strategies you can use to make money, and how you can avoid many of the pitfalls and problems that doom many less experienced traders. Our purpose is to help you make the transition to after-hours trading as uncomplicated as possible. Like any new trading system, it takes a while before you'll become comfortable with it. We hope to dramatically speed up the time it takes for you to reach your financial goals.

After reading our book, you might never look at the stock market in the same way again. Our hope is that you will learn how to trade differently and perhaps make a lot more money along the way. It definitely won't be easy, but we know you will find it fascinating. If you are new to the market, trading in the dark might seem a bit frightening. In time you will see that you have little to fear but the limitations you place on yourself.

Our goal is to arm you with the knowledge and tools you need to be a successful after-hours trader. The more knowledge you have on how Wall Street really works, the better your chance to have fair and equal access to the markets. The idea is to show you how to trade stocks the same way the pros have been doing

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for years. We think you should get a fair shake on Wall Street so you can win or lose fairly without one side having an unfair advantage.

We believe that once you learn how to make money from the convenience of your own home at a time that fits your schedule, you will never want to go back to the old way of doing business. Although we don't expect you to trade stocks all day and night, after-hours trading allows you to trade when it is convenient for you, not at an arbitrary time that meets the needs of Wall Street.

You should also be aware that the rules on Wall Street are changing. The stock market you see today will look completely different over the next couple of years, even over the next few months. It is the same with the after-hours market. If you want to be a successful trader, you must plan for and welcome the future. We see the after-hours market as one of those rare events that can bring wealth to those who take the time to understand how it works. Some will see after-hours trading as an inconvenience; others will see it as an opportunity. As the world changes, change with the world so you will be in the best position to know what to do next.

After reading our book, we hope you'll share our enthusiasm for after-hours trading. Although the market goes up and down, if you truly learn how to win the stock market game, we think you can make money during any market condition. All it takes is a little courage, imagination, and time. The next step is yours, and we want you to take it. We wish you the best of luck and much success.

Michael Sincere

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INTRODUCTION

The people who are helping to make after-hours trading a reality already feel they are in the middle of a revolution that will forever change the way people invest in the stock market. Some very powerful people put their careers and companies on the line to make the after-hours market a success. A few have an almost religiouslike fascination with the fact that after-hours trading is forcing Wall Street to reinvent itself for the first time in its 200+-year history.

Others view after-hours trading as nothing more than a step in the right direction, a way to give individual investors the same rights and privileges as institutional investors. It doesn't matter whether you think after-hours trading is the greatest idea since the Internet or simply another tool to help individual investors level the playing field with institutions—this book was written for you.

To those people who still do not see the bigger picture, after-hours trading might not seem like such a historic event. Then again, neither did the Internet when it was first introduced over 30 years ago. Ironically, after-hours trading also began over 30 years ago, but unlike what happened with the Internet, individual investors were not allowed to participate. It's only been in the last year that retail investors were welcomed into the exciting and potentially profitable after-hours market. The time is right for the individual investor to play the after-hours game with the same rules and privileges as the pros. It's a new world out there with endless opportunities for individuals to gain wealth.

OVERVIEW OF BOOK

In Section I of our book, we will give you an overview of the after-hours market, including a brief history of why the emergence of after-hours trading became so controversial. We call it

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the "war on Wall Street," and no one knows for sure who will end up as winner. We will show you why so many professional traders have resisted after-hours trading in the past and how it is affecting the way Wall Street will do business in the future. Nearly all the major players are competing among themselves for a bigger piece of the retail investor pie. Many are genuinely interested in giving the retail investor equal access to the market—and at prices that are consistently more competitive than the current system offers.

In this section, we also compare and contrast all the major after-hours players, including the online brokerages that offer after-hours trading and the electronic communication networks (ECNs) that work behind the scenes to match customer buy and sell orders. If you are relatively new to online trading, we tell you how to open up an online account and what you need to do before you make that first after-hours trade.

In Section II, what many will find to be the most useful part of the book, we reveal a number of basic strategies, what we call 1-minute strategies, geared to the retail investor who is just learning about after-hours trading. We have tried to keep the strategies short and simple. The goal is to introduce you to strategies that could increase your income and do wonders for your portfolio.

We also describe in this section the characteristics of winning traders. Although this book is geared toward after-hours trading, you can use this information to improve your performance in the regular market. We have learned from our research that the most profitable short-term traders share many of the same characteristics as profitable long-term investors. As you will discover, both are disciplined and analytical, passionate about investing, and extremely knowledgeable about the trading strategies they use. We hope that you will find success by emulating the positive characteristics of the most successful traders and investors.

Although we'd like to tell you that after-hours trading is as simple to understand as the regular market, the truth is, there are definite pitfalls, and we describe them in detail in this section. Although some of the risks of after-hours trading will be eliminated over time, it is essential that you know exactly what you

are getting into before you commit your hard-earned money to the market. One of the most basic rules of smart investing is to look objectively at all the potential risks of a transaction before you think of the profits you could make. Although the after-hours market will provide you with additional opportunities to make money, you must not enter with your eyes closed.

Unfortunately, it also takes more than knowledge and the right tools to make money in the market. The people who are most successful aren't necessarily smarter than other traders; rather, they have acquired the necessary psychological characteristics that allow them to profit in nearly all market conditions. So in this section we will show you ways to improve your discipline. We will also try and point out the type of characteristics you'd be better off avoiding, the kind that can cause havoc with your portfolio.

We begin Section III by discussing the rules of the after-hours game, including which rules might change in the future. The after-hours market is evolving and changing in ways that even their supporters couldn't predict a few months before. In this section, we also give our best analysis of how the after-hours market might look like in the future and how the competitive pressures that brought after-hours trading will likely change Wall Street. We believe there are tremendous opportunities for individual investors and traders to take advantage of what is occurring on Wall Street. In this section, we try and point out those financial opportunities.

As a special treat to our experienced traders, we included a chapter (Chapter 9) on advanced strategies for short-term traders. Many night traders are already participating in and profiting from the after-hours market. In this chapter, we reveal quite a few of their tricks. Even if you are not a short-term trader, you can profit from this information. However, keep in mind that some of the strategies are definitely high risk.

Finally, one of the best ways to learn about the after-hours market is to talk to the experienced professionals who trade for a living. Our last chapter includes interviews with two professional short-term traders, Halbert Uy and Michael Campion, who reveal how they make money by trading stocks at night. For some of you, this chapter will be the most valuable part of the entire

book. It is extremely helpful to find out the secrets and insights of professional traders who make and lose money nearly every night.

Although the events surrounding after-hours trading have been changing almost as fast as we have been writing about it, we have sought to make this book as timeless as possible, which is one of the reasons we have spent so much time on strategies. Years from now, even as the after-hours market turns into a 24-hour global market, we believe these strategies will still be valuable.

We think it is about time the retail investor was treated fairly on Wall Street. From outrageously high commissions to order-routing games that guarantee the worst prices for investors, many pros are eager to profit from your inexperience and lack of knowledge. Although the rules are rapidly changing, it is still your responsibility as a retail investor to learn as much as you can about what is happening with your money.

This book could not have been written without the help of many people who agreed to talk with us about after-hours trading. These include some of the most knowledgeable market players on and off Wall Street—people who work at major online and full-service brokerages, people from the SEC, market makers and specialists, and members of the Nasdaq Stock Market and regional stock exchanges, as well as the group that started it all, ECNs. Even though there is a lot of competition for your business, the major market participants know it is in everyone's best interest to give you a fair and equitable stock market. After speaking with many of the leaders and professionals who are making after-hours a reality, we are confident this is going to happen.

IT'S UP TO YOU

There has never been a more fascinating and exciting time for individuals to participate in the stock market than right now. Because of the power of the Internet, you have as much information, tools, and resources as many institutional investors. Today's retail investor is more knowledgeable about the market, more

savvy about technology, and more willing to manage his or her investments without the help of a stockbroker or financial consultant. This generation of investors is remarkably independent—you have made it very clear you want to trade stocks your way.

This book will show you how to trade stocks with the same tools and the same knowledge as the pros have enjoyed for years. Like any profitable enterprise, it does involve risks. In the end, we believe the advantages of after-hours trading will far outweigh the disadvantages. Once the minor kinks of the new market are worked out, you will be left with a powerful, flexible, and convenient electronic trading system that will be available to you any time of the day or night.

Once the rest of the world realizes how easy and convenient it is to trade stocks at home literally 24 hours a day, they will flock to the after-hours market. If you don't believe this will happen, remember that in 1995 there was only one online brokerage and only a handful of online traders. Now, people can't seem to get enough of trading online in the comfort of their own home. We believe the same will happen with the after-hours market.

And now, we're ready to introduce you to the newest and hottest game being played on Wall Street: after-hours trading. Hold onto your seat. This is an experience you're not likely to forget anytime soon.

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SECTION I

Learning How to Play the Game

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1

WHAT IS AFTER-HOURS TRADING?

Halbert Uy, a professional after-hours trader, recognized a buying opportunity when a late-breaking news announcement flashed across his computer screen at 3:52 p.m. eastern standard time (EST). New Tel Ltd. (NWLL), an Australian telecommunications company, was teaming with a government-owned Chinese news agency to provide an Internet Service Provider (ISP) and an Internet portal. It was not the fundamentals of the company that caught Uy's attention, but the key words contained in the press release: "ISP," "Internet," and "China." These were all hot themes that could appeal to short-term traders looking for the next momentum play. It didn't hurt that the company was thinly traded, with an average volume of fewer than 35,000 shares a day. Because Uy understood the relationship between the late-breaking news and a low-volume stock, he bought 1,000 shares of NWLL at 8⁷⁄₃₂ a share and another 1,000 shares at 8¼.

After the regular 4:00 p.m. EST market close, NWLL rose as high as $28 a share during the after-hours session. Although Uy could have sold NWLL for a huge profit the same day, he held it overnight, hoping the momentum would carry the stock even higher the next day. As it turned out, he was right.

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The next day, NWLL continued to surge, reaching as high as $51 a share. Uy sold his shares between 28⅛ and 48 7/16, pocketing $47,500. Ultimately, by the end of the week, the stock fell back to 31½, dropping to 13⅞ a week later.

Whether you are aware of it or not, the after-hours market is coming to a stock market near you. Already, thousands of specialized short-term traders like Uy have discovered that they can make money buying and selling stocks after the regular market closes or before it opens. For professional short-term traders, the objective is to consistently find new and more profitable ways to increase their profits, and the after-hours market is their new arena.

The move toward after-hours trading has been controversial. Proponents say that after-hours trading gives individual investors the same access to the market that it gives institutional investors. Critics, on the other hand, have said this trading is simply an extension of a speculative bull market. Some even characterize after-hours trading as a casino or the Wild West rather than an organized stock market. Others characterize night traders as more akin to firefighters, with long periods of boredom punctuated by short and intense action.

No matter what your opinion, nearly everyone agrees that after-hours trading is here to stay. Now that thousands of online traders and investors have had a taste of the possible profits that after-hours trading can bring, it will be impossible to return to the old ways. If anything, the after-hours market will extend even longer, perhaps moving to a fully operational 24-hour market. All you have to do is look at the numbers to see that trading after hours is becoming increasingly popular. In the early days of the after-hours market, retail investors traded no more than a few thousand shares. But those figures are increasing every quarter, with Instinet and Island ECN handling most of the volume. For example, the Dow Jones newswires reported that after-hours trading activity was increasing each month, to almost a billion shares traded during the month of January 2000 alone.

There is little doubt the after-hours market has created a revolution in personal investing that will affect the life of everyone who invests or who works on Wall Street. It will affect how you buy and sell stocks or mutual funds, when daily newspapers report stock quotes, how financial television programs report on

the market, and when companies release their earnings reports. The birth of after-hours trading has already caused more changes on Wall Street in the last year than have occurred in over 200 years.

You can probably point to the Internet as the source of most of the mind-boggling changes. The Internet helped create an entirely new group of do-it-yourself investors who are unwilling to leave all investment decisions to stockbrokers and professional fund managers. These investors demanded cheaper commissions, faster order execution, and the ability to trade at any time of the day or night. The retail after-hours market was created to meet the needs of traders and investors who wanted equal and fair access to the stock market. Many people are betting their careers that the after-hours market will give them additional opportunities to make money.

We've come a long way since the days when you had to place your trade through a highly compensated stockbroker. The Securities Act Amendments of 1975 banned fixed commissions, and from that the discount broker was born. First, people asked for lower stock commissions. They got their wish, as commissions dropped from hundreds of dollars per trade to less than $10 today. Then people asked for faster trade executions. Thanks to the Internet and the online brokerages, your stock orders can be executed almost as fast as you click your mouse. And now, many people are asking for convenience—that is, the ability to trade stocks during the day or night at a time that best fits their schedule. They do want to trade stocks after the regular market closes, presumably after they get home from work. The after-hours market was designed to meet the needs of these investors.

Beginning in late 1999, major financial cable stations like CNBC and CNNfn let their viewers in on the after-hours market action. The words "Extended Hours" flash across the CNBC screen beginning at 4:00 p.m. each afternoon as the reporters explain how particular stocks are performing in the after-hours market. CNBC even has a reporter assigned exclusively to cover the most active stocks during the after-hours market. In addition, nearly all the financial newspapers let you know how the major stocks performed in the after-hours session, especially when important news breaks after the market close.

Even financial journalists have picked up on the after-hours activity, routinely reporting on the most active stocks or those with the biggest gains. The sudden volatility of stocks in the after-hours market has intrigued the public. Until recently, most retail investors could only watch idly from the sidelines because their brokerages didn't have the means to let them participate.

Although many believe the after-hours market is a recent development, in reality, the major institutional investors, for example, mutual fund companies, stock brokerage companies, and pension funds, have been trading stocks after hours for several years. The institutions primarily used the services of Instinet, a huge global agency broker owned by Reuters, the British financial publisher. Instinet operates one of the largest electronic communication networks for institutional customers, which is also named Instinet. Agency brokers don't trade for their own account but act in a neutral manner to match buyers and sellers.

When Instinet was designed 30 years ago, it was to be used exclusively by professional traders, not individual investors. At the time, before the introduction of the Internet or online brokerages, many professionals felt that individual investors weren't sophisticated enough to trade stocks among themselves. Besides, the cost of owning an Instinet terminal was prohibitively expensive.

Instinet allowed institutions to match buy and sell orders among themselves. They were also allowed to make trades outside regular market hours. Nearly every major institution has a dedicated Instinet workstation installed in its office, adding up to more than 18,000 terminals worldwide.

The beauty of Instinet was that institutional investors could make large trades anonymously without having to go through a broker. This anonymity allows institutions to trade without drawing attention to their actions. For example, if a mutual fund wanted to sell a million shares of a stock, it could sell it via Instinet under complete anonymity. The buyer would have no idea who the seller was or the total number of shares available for sale. If the buyer were to send the order via a broker, news of a large order could circulate around trading desks and allow others to sell in front of the order. Instinet is an order-flow-driven market; in other words, it directly matches the orders of buyers

and sellers without using middlemen. These middlemen, also called market makers (on the Nasdaq Stock Market) or specialists (on the New York Stock Exchange), buy and sell stocks out of their inventory to make sure that every trade is two-sided.

Rather than using middlemen, Instinet trades work like this: The institutions post a message on Instinet stating they want to buy or sell a given number of shares at a specified price. There is no guarantee they'll match the price they want, but if there is a match, the trade will be instantly and electronically executed. Keep in mind that millions of shares of stock are traded on Instinet every night. This trading system has worked remarkably well for the institutional players who have billions of dollars in trading capital.

The system gave institutions opportunities to place trades outside traditional market hours. After the closing bell at 4:00 p.m., many of the stocks that individual investors owned were still trading into the evening. Retail investors and short-term traders who were not included in after-hours trading often felt like wallflowers at the high school prom. They were being locked out of the opportunities that the professionals had after the regular market closed. In particular, day traders wanted a chance to profit from company news released after 4:00 p.m. For example, if a company released positive or negative news after the market closed, institutions were able to buy or sell the shares of stock among themselves. Let's say there is negative news; for example, a company unexpectedly announced that its auditors resigned and the company would have to restate its earnings for the last three quarters. Institutions had the opportunity to react immediately to the news by either unloading their shares and cutting their losses or adding to their existing positions. For retail investors, nothing is more frustrating than waking up to find out you lost 30 to 50 percent of your investment and you're helpless to do anything about it.

Of course, it worked the other way too. If a company announced better-than-expected earnings, the stock could soar after the market closed. Momentum traders (those who buy stocks when the price of a stock is rising quickly) and institutions would be able to react immediately to the positive news. Meanwhile, retail investors would be forced to wait until the

next day before they could act on the good news. By that time, the stock could be much higher.

Even if knowledgeable retail investors heard late-breaking news at the same time as institutional investors, they couldn't make a trade. The best the retail investors could do was place an order for the next business day, when they would have to compete with positive comments from analysts and the media. The stock that retail investors wanted to buy after hours was now gapping (rising) up even higher because, for example, of a positive mention on CNBC. In this situation, thousands of retail investors were trying to buy the stock at the market open. The momentum traders who bought the stock the night before would be trying to sell as soon as the price shot up higher.

If there is one thing we hope you learn in this book, it is to not place market orders on stocks. We have learned from experience that if you place a market order on a stock, instead of getting the best bid or ask price, you will often get the worst. Even more frustrating, in a fast-rising market, you could wait several minutes before your order is filled. Remember that any order that is filled within the first 30 minutes of the market open can be considered a timely fill and you will have no recourse with your broker. Some of the excuses you might hear: "It was a fast market" or "There were other orders ahead of you," are all standard excuses taught to customer service representatives.

What is really sad is that thousands of uninformed investors allow themselves to be subjected to this maneuver every single morning. A number of online brokerages, including Schwab, report that up to 15 percent of their orders are placed in the middle of the night, not as after-hours orders, but as next-day market orders. If investors understood how their market orders were handled, we are sure that they would be reluctant to place them in this manner.

You might wonder if it is possible for the little guy, the individual investor, to get a fair shake on Wall Street. If the stock market were really fair, you should have the same access to the information and prices that institutions have. Although this definitely wasn't the case just a few years ago, a number of steps have been taken by the government to ensure that individual

investors get a more equal playing field when participating in the stock market.

Opening access to off-hours trading is the first step in what some have called a revolution. The next step will be open access to company conference calls, free real-time quotes, and disclosure of the same information that analysts receive. Although there has been a lot of resistance to many of the changes sweeping across Wall Street, everyone agrees it is too late to stop progress—even though some on Wall Street are still kicking and screaming about altering a system that has worked so well for so long.

What is the driving force behind all these eye-popping changes? The answer is actually quite simple: competition. As you may remember, it wasn't too long ago that competition forced phone companies to offer lower prices, faster service, and superior phones. Similarly, competition and even the threat of competition have forced the biggest players on Wall Street to provide investors with cheaper, faster, and more convenient access to the stock market. The revolutionary shift to after-hours trading is just one small tip of this iceberg.

We think it is about time that the retail investor got a fair and equitable stock market where everyone plays by the same set of rules. Although many people don't want to tinker with a system that brought untold wealth to a select few, it is obvious that nothing is going to stop the dual forces of new technology and increased competition. In the end, it is you who will benefit the most.

HOW CAN THE AFTER-HOURS MARKET HELP YOU?

Although what is taking place on Wall Street makes a fascinating story in its own right, you might wonder if it is really worth your time or effort to trade during the after-hours market. After all, if you really want to trade stocks that badly, you can probably find time during the day to participate in the regular market. Right?

Maybe, maybe not. If you live on the West Coast, the market closes at 1:00 p.m., just about the time you have finished lunch. And if you are like many people, you have a 9-to-5 job that keeps you pretty busy during the day. If you're lucky, maybe you can catch a glimpse of the market if you are working on your computer during work hours. But it's likely your boss won't be pleased to find out you are trading stocks on company time, which brings us to the number one reason why after-hours trading is going to become popular with millions of online traders: convenience.

CONVENIENCE

If you are the type of person who likes to buy and sell stocks on your own but you don't have the time during the day, the after-hours market should meet your needs. We know that many people slip in a stock trade or two while at work. Because of the popularity of the Internet, buying stocks online is as easy as buying a book from Amazon.com or placing a bid on eBay. As you know, however, just because it's easy to buy a stock online doesn't mean it's easy to make money. In fact, because it takes so little effort to click a mouse and buy stocks, there is a greater likelihood that you will make mistakes. We hope that by the time you finish reading this book, you'll have learned how to make money in the after-hours market while avoiding many of the pitfalls that doom so many novice investors.

The ideal time to trade stocks is not when you are busy at work or during a lunch break but when you are in the comfort and privacy of your own home. That is why we think you are going to like after-hours trading. You can place trades when you want at times that fit your schedule rather than at times arbitrarily set by what is convenient for Wall Street. Most important, you don't have to quit your full-time job to trade stocks. Unless you have a flexible workday, it is nearly impossible for you to devote enough time to your stock portfolio while you are at work. The after-hours market will give you the time you need to trade without interfering with your full-time job. You work all day, and now you can trade all night.

It is not just West Coast investors who are going to flock to the after-hours market. We also think that investors in Asia and Australia are going to discover they can trade stocks in the U.S. market without having to get up in the middle of the night. The influx of foreign investors into the after-hours market is one of the reasons many people think the liquidity will keep improving. Let's also not forget about investors in Hawaii, who have routinely been penalized by a 5- to 6-hour time difference. When the regular market opens at 9:30 a.m., it's the middle of the night in Hawaii. The after-hours market gives those in earlier time zones the ability to trade stocks when it's more convenient for them.

BREAKING NEWS

Although convenience to trade at reasonable hours is important, many traders claim the real reason they want to participate in after-hours trading is to profit from late-breaking news, especially corporate earnings announcements. As we mentioned earlier, corporations traditionally release earnings reports after 4:00 p.m. to allow ample time for the dissemination of information. Institutional investors are the first to react to the news by trading among themselves on Instinet. Now, for the first time, retail investors like you are also able to react immediately to late-breaking news by buying or selling in the after-hours market. This gives you an equal chance to protect your gains or perhaps profit from the late-breaking news.

One of the biggest complaints from individual investors is their not being given the same opportunity as institutional investors to profit on news. If you are a short-term trader, trading on the news provides you a tremendous advantage over other investors. As an after-hours trader, you won't have to wait until morning to make the trade, a time when it is often too late. Although it can be extremely profitable to trade on the news, it can also be extremely difficult. After all, you are competing against professional traders who have the best technology and resources. Remember that the traders with the best and fastest information will succeed. If you do get it right, however, you can beat the pros at their own game.

When there is negative news on your stock, you can also use the after-hours market to cut your losses and minimize potential damage. For example, on Thursday, January 6, 2000, Lucent Technologies (LU), the most widely held stock in the market, issued a late-afternoon press release warning that its first quarter earnings would fall well short of expectations. The stock was halted on the news at 69⁹⁄₁₆. When the halt was lifted at 4:52 p.m., in the middle of the after-hours market, investors began selling. On Instinet, Lucent immediately dropped to $60 a share. By 6:00 p.m., the stock was selling at 50½.

Ironically, after Lucent plummeted on the news, other technology stocks sold off during the after-hours session. Imagine waking up on Friday morning as thousands of other investors did to find out your stock fell 18½ points in the middle of the night and there was nothing you could do about it. Now, if you time after-hours trading correctly, you can either profit from good news or protect your portfolio on bad news. If you see a plummeting price, you can exit your entire position, saving yourself thousands of dollars.

Compare yourself to Fidelity, the giant mutual fund company, which owned approximately 81 million shares of Lucent. With such a large position, there was no way it could have reacted in time to minimize its losses. There just wasn't enough liquidity for a giant institution to exit in time. As a retail investor, you have a unique advantage over many institutions. The after-hours market, contrary to what many people think, gives smaller investors enough liquidity to prevent a major portfolio catastrophe.

BETTER PRICE FILLS

A number of online brokerages claim that more than 15 percent of their orders come from customers in the middle of the night. These are not after-hours trades but market orders that will be filled as soon as the market opens at 9:30 a.m. EST. With a market order, you are guaranteed a "timely" fill for your order, although by the brokerage's definition, 30 minutes can be considered timely. Many of these market orders by retail investors sit in a queue each morning waiting to be processed at the next

available price. There is nothing more frustrating than waiting 20 to 30 minutes to receive a report back from your broker on a market order. In other words, when you place a market order in the middle of the night, you have no idea at what price it will get filled the next morning.

We could tell you dozens of horror stories of individual investors trying to buy a fast-moving stock at the opening and getting it filled at outrageously high price levels later that morning. You are stepping in with thousands of other investors with a market order to buy at whatever price you can get. The fill prices of some of these stocks can be shocking.

Let's say you heard about a hot initial public offering (IPO) of VA Linux Systems (LNUX) and decided to place a market order to buy it the next day. Let's see what actually happened with this particular stock. LNUX was priced at $30 a share by Credit Suisse First Boston on December 8, 1999. The next day, when trading began, it immediately opened at $299 and climbed as high as $320, finally closing at $239¼, a spectacular gain of 698 percent from the initial offering of $30.

If you had put in a market order for this one, we are pretty sure you would have been dissatisfied with your execution price. Thousands of investors undoubtedly were taken for a roller coaster ride on this stock and paid dearly for the experience. By the time your market order was filled, instead of getting the $30 price you dreamed of, you likely would have gotten filled at somewhere between $300 and $320.

You could learn some valuable lessons from this scenario. When you place an order in the after-hours market, you must use a limit order, which means you have to specify the exact price and quantity of your order. As you will learn when you read our book, we think limit orders are a good idea no matter what market you are participating in. In the case of LNUX, had you placed a limit order early that morning, the stock would have blown past your order, and you probably wouldn't have gotten filled at all. But wouldn't that be better than buying the stock at over $300 a share and watching it plummet?

If you had waited until the after-hours market, with the stock already at $239, you could have made a little profit on the stock if your limit order had been one of the first. At least with a

limit order you know the exact fill price of your order before you turn out the light and go to sleep. Perhaps you won't get matched at all, but at least you'll be able to sleep without worrying about the fill price.

The after-hours market will help to eliminate many of the poor order fills that are placed each morning by millions of uninformed investors. Ironically, many day traders wait until at least 10:00 a.m. before they enter their first order. They like to wait until the noise from many retail investors is cleared. Later, we discuss a number of strategies you can use to help get the best price for your orders.

EMERGENCY ORDERS

Many short-term traders use the after-hours market to get out of losing positions or to reverse trades they mistakenly made during the regular market. The after-hours market is a convenient place to make changes to your portfolio or add or eliminate stocks. It is nice to know that the stock market could be open at any time of the day or night. Once you realize how convenient it is to trade stocks until 8:00 p.m. or 10:00 p.m. or perhaps later, you will never want to go back to traditional hours.

If you don't think that people will ever get used to trading after hours, try to imagine what would happen if your bank said that you could use ATM machines only until 4:00 p.m. What if all stores closed at 6:00 p.m. as many do in Europe? Although it may not seem possible if you are not an active trader, you never know when you may have to make an emergency trade well past the normal closing time of 4:00 p.m.

On October 17, 1987, when the Dow Jones Industrial Average dropped 23 percent in one day, investors frantically placed millions of sell orders. Many feared they would not have enough time to sell their stocks by the end of the day. Imagine going into a crowded room to report a fire in the building knowing that the doors would be locked at 4:00 p.m. A mad panic and simultaneous rush for the exit would ensue. The feeling that you had to sell by 4:00 p.m. or you'd lose all your money contributed to the extraordinary panic experienced by retail investors in 1987.

Perhaps had there been an after-hours market at that time, the pressure to sell wouldn't have been so great. It's comforting for many people to know that the market remains open well past the traditional closing times. It is also clear that today's investor has much more information about the stock market than he or she did in 1987. It was the frightening feeling that you didn't know what was happening to your stocks that helped lead to the extraordinary market crash. Still, in an emergency, it's nice to know the market will be open when you want it.

TRADE STOCKS ANYWHERE

We can't wait to see what happens when people discover they can trade stocks anywhere in the world—say, while waiting in line to board an airplane, or before checking into a hotel, or standing in front of the Eiffel Tower. Simply hook up a laptop computer to any available telephone line or use any number of wireless devices and trade stocks wherever it is convenient. You can make money almost any time of the day and well into the night, a feat made possible by a combination of the Internet and new wireless communication devices.

In fact, we have successfully used the 3 Com Palm Pilot to send and receive e-mails, check quotes, and make emergency trades while waiting in traffic or sitting on a Florida beach. We don't mean to imply that you can make a living trading stocks while at the beach or lounging at the pool, but wireless makes it possible. We think the up-and-coming wireless technology will eventually bring more after-hours traders into the marketplace.

Does this mean that everyone should trade stocks while waiting in line at the supermarket or eating dinner at a restaurant? Of course not. Convenience should not be used as a reason or excuse to trade stocks. Just because it's easy to buy a stock doesn't mean it makes sense to do it. That is why it's so important for you to read this entire book before you commit a dime to the after-hours market. If you're not paying attention while trading stocks, the professionals who get paid to pay attention will relieve you of your money every night.

WHO WILL BENEFIT THE MOST FROM AFTER-HOURS TRADING?

Some pros hint that the after-hours market is a clever trap engineered by greedy professionals to take advantage of unsuspecting investors. Remember that the after-hours session is not just an extension of the regular trading day (at least not yet). It has its own rules and strategies. Ultimately, you are the only one who can decide if the after-hours market is a tremendous financial opportunity that will increase your net worth or another method to take money from unsuspecting investors.

Many retail investors have already made it clear they want to trade at night. The millions of shares of stock now being collectively traded each night at every major online brokerage and exchange will only increase as millions more people open up online brokerage accounts during the next year. It seems likely that an electronic after-hours market will one day be the preferred way of doing business on Wall Street. Quite a few major Wall Street players have, in fact, bet their careers on it.

ONLINE INVESTORS

You may wonder why a long-term buy-and-hold investor would be attracted to the after-hours market. After all, many online investors typically make no more than 25 trades a year. The truth is that online investors, no matter what strategy they use, will be attracted to the after-hours arena for the same reason traders are attracted: convenience.

This book shows you how you can keep your full-time job and still trade stocks both before and after work in the quiet of your own home, an ideal environment to place trades and conduct research. Like many professional traders, investors can use the after-hours market to analyze the most profitable opportunities and take action only when they arise, even if it's only a couple of times a month. We have included a number of short-term strategies that long-term investors can use to increase their profits in the extended-hours market. Regardless of how you place your trades, whether through a stockbroker or an online broker,

you will be able to place trades at night when certain news affects your portfolio. Most brokerage houses allow you to have a stockbroker or financial consultant and still place your own trades at night.

SHORT-TERM TRADERS

The after-hours market is an ideal environment for short-term traders who want to participate in the stock market without giving up their full-time job. This book has been designed with these traders in mind. We show you specific strategies to use to profit from late-breaking news announcements and ways to take advantage of the unusual trading environment of the after-hours market. The strategies described in Chapter 9 are specifically designed to help experienced short-term traders profit from after-hours trading.

Although it seems like everyone has something negative to say about day traders, the truth is that a number of people have done exceptionally well using specific short-term trading strategies. When people think of day trading, they are usually referring to intraday trading, the strategy of buying and selling stocks for ⅛ and 1⁄16 profits. Night trading, difficult in even the most liquid market environment, is even harder during the extended-hours session. This is one of the reasons that many professional intraday traders who thrive on volatility and liquidity have avoided trading in the after-hours market. We do think, however, that night traders will eventually participate in the after-hours market when there is breaking news or momentum plays.

On the other hand, traders who use other short-term strategies, such as swing trading, may find the after-hours market a potentially lucrative arena. Swing traders tend to hold stocks from 1 to 5 days rather than for 1 to 5 minutes, aiming for larger-point profits. Contrary to what many critics say, it is possible to make money in the after-hours market using short-term trading tactics. It isn't easy, especially since you are competing against professional traders, but it is possible to succeed. If you want to try short-term trading but don't have time to do it during the day, the strategies we offer should meet your needs.

WEST COAST INVESTORS

For so many years, the wishes of West Coast investors have generally been ignored. Traditionally, Wall Street has set trading hours most convenient to East Coast investors, forcing West Coast investors to greet the opening bell of the NYSE at 6:30 a.m. EST. Not everyone has complained, however, because it does allow early risers a chance to place a few trades before work.

Nevertheless, most believe that West Coast investors will be the most excited about after-hours trading. After all, when the market closes at 4:00 p.m. EST, West Coast investors are just getting back from lunch. The after-hours session will allow these people to have a more normal trading day.

Let’s also not forget our friends in Hawaii, who are 5 to 6 hours behind Eastern Standard Time. Hawaiians are looking forward to longer market hours so they can participate in the market without getting up at 3:00 a.m. With the advent of after-hours trading, if you live in earlier time zones, you will no longer be punished by a market geared to the convenience and lifestyle of East Coast investors.

INTERNATIONAL INVESTORS

A new generation of European investors who grew up on the Internet are using the stock market to increase their wealth. We have a number of friends in other countries, especially Sweden, Iceland, France, Germany, and England, who routinely pool their money so they can trade in the U.S. and international stock markets. Most U.S. online brokerages allow international residents to open trading accounts, as long as they fill out IRS form W-8BEN, which allows the IRS to take a 30 percent share of stock profits.

Many of our friends would trade 24 hours a day if they didn’t have to work or go to school. It is definitely the latest craze sweeping Europe, and it will probably continue for some time. A major drawback to trading stocks in Europe, however, is the outrageously high cost of local telephone calls. Unlike companies in the United States, which allow investors and traders free and unlimited calls to their local Internet Service Provider, the major telephone companies in Europe charge by the minute.

Although the United States discourages monopolies of any kind, especially by telephone companies, in Europe the game is played differently. As a result, many local telephone companies in Europe are slow, technologically inferior, and costly. One day the Europeans will wake up to the fact that the lack of competition among local phone companies is costing them dearly, in both money and time. Don't forget that it was only a decade or two ago that we had the same problem.

By the way, the Nasdaq Stock Market, as well as a number of online brokerages, is working with European and Asian stock exchanges to allow international investors to trade U.S. securities. Many foreign students, in both the United States and Europe, have discovered that trading stocks is more exciting than playing video games and potentially a lot more profitable. Unlike their parents, who are a bit more cautious with their financial affairs, these younger European investors are looking for any opportunity to make money. The 24-hour market will be waiting for them when they're ready.

OUR GAME PLAN

The ultimate goal of our book is to show you how to compete and profit in the newest and most fascinating game on Wall Street: after-hours trading. We provide you with the facts so you can decide for yourself if this is a market you want to participate in. Like any new trading environment, there are risks as well as rewards. In the after-hours market, moves tend to be exaggerated because of lower liquidity and fewer market participants. On the other hand, the after-hours market provides you with unique opportunities not found in any other market. The sooner you understand the mechanics, the better you will able to take advantage of these opportunities. With the information we've included, you'll be better able to decide if after-hours trading is for you.

It is our responsibility, which we take very seriously, to prepare you for the risks and rewards of after-hours trading. Even if you decide not to face the challenge, you should at least understand why after-hours trading is so exciting. The sooner you

learn how after-hours trading works, the better position you'll be in to take advantage of profitable opportunities. You may have been late with the Internet revolution, but you're right on time to bring after-hours trading into your living room.

We don't want you to think that all you have to do is show up after the close to make money instantly. It's a nice thought, but a giant misconception. It's extremely difficult to consistently make money trading in the regular market, and trading after hours is no different. Some people would prefer going to an exercise class or watching television, so don't be surprised if others don't share your enthusiasm. It takes the right combination of skill and dedication to trade successfully. If you learn all the rules and methods for after-hours trading, you will be in an ideal position to profit from the changes that are sweeping the investment community. Rather than fear change, we urge you to embrace it.

For years, the pros have had all the breaks. After-hours trading was created by professionals for professionals seeking an edge over the retail public, which was locked out of participating. For almost the first time in the history of the market, you have been given a chance to compete head-to-head with the institutional investors. Although the rules of the game are still being written and rewritten, nothing should prevent you from participating in this exciting and potentially lucrative market. If you understand the rules and employ the proper strategies, you can use the stock market to generate more wealth for yourself than you ever dreamed possible.

In the end, only you can decide if after-hours trading makes sense for your personality and lifestyle. We want to show you not only how to survive but how to win. Our only purpose is to provide you with the information and strategies you need to trade stocks on an equal level with the pros.

Now that you have a better idea of what we mean by after-hours trading, we'd like to give you a short history lesson. In the next chapter, we will show you how the after-hours market got started and why so many people on Wall Street were uncomfortable with a longer trading day. The war on Wall Street, as we call it, is still being fought.

2

THE WAR ON WALL STREET

THE BATTLE LINES ARE DRAWN

You can probably blame the Internet for permanently changing the way that stocks are traded. It was hard enough for some people to put away their slide rules and calculators to make way for the personal computer. The Internet, however, appeared out of nowhere to challenge the remarkably successful business model that Wall Street created over 200 years ago. In time, it became clear that anyone who ignored the technological revolution that was sweeping the nation would end up as profitable as a twenty-first-century buggy whip factory.

The New York Stock Exchange (NYSE) has had a long and proud history, beginning in 1792 when two dozen brokers and merchants met under a buttonwood tree on Wall Street to sign the Buttonwood Agreement, creating the nation's first organized stock market. It is likely these men could not predict that, from these rudimentary beginnings, the New York Stock Exchange would evolve into one of the most powerful and elite financial centers in the world.

These brokers and merchants also created a fixed-commission structure for every trade, an arrangement that lasted

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nearly two centuries. At first, they charged a tidy 25 cents per trade. Over time, these commissions grew higher and higher, until finally, Congress totally abolished the fixed-commission structure on May 1, 1975, a day known on Wall Street as "May Day." The end of fixed commissions created one of the most intense periods of price competition in Wall Street's history.

Competitive pricing, however, was not seen as a positive step to those who worked on the Street. In fact, anything that promoted competition was strongly opposed by the NYSE and many of its member firms. Nonetheless, May Day opened the door to the first discount brokers, who immediately undercut full-service brokers by offering lower commissions. Contrary to what many experts predicted, the lower commission prices lured more people into the stock market, substantially increasing the profits of many brokerage firms, while at the same time putting some of the smaller brokerage companies out of business.

While the ending of fixed commissions certainly was one of the most dramatic events in Wall Street history, no one was prepared for the revolution that would shake Wall Street to its core: the Internet. It is understandable that those who grew up in the exclusive country club atmosphere of the NYSE were shocked that anyone would even consider doing stock transactions on the Internet, especially without the help and guidance of a stockbroker. It went against everything that Wall Street stood for. "The Internet is only for pornographers and pedophiles," fumed the CEO of one full-service brokerage firm. It didn't take long, however, for Wall Street to realize that the Internet, in conjunction with point-and-click Web browsers, was much more than just a passing fad. In a few short years, the Internet would emerge as the most serious threat to Wall Street since its inception. This Internet thing was different, and even Wall Street was surprised by how much.

To understand why people on Wall Street felt threatened by the Internet, you have to understand how you, the individual investor, fit into the picture. For years, the retail investor got about as much respect as a kindergarten child on the first day of school. You were led to believe that trading stocks was too difficult to do on your own. You needed the skill, guidance, and advice of professional stockbrokers, who studied hard for

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months to pass their Series 7 exam and knew so much more than you. For too many years, individual investors believed nearly everything the pros told them. The pros wanted you to believe that the less you knew about how the stock market worked, the better. Their message: Trust us to make responsible choices and charge you a small fortune for the privilege.

And at the same time, many of the pros who made a living in the stock market laughed at how ignorant you were about the market. A popular joke that made the rounds was that if you wanted to know which direction the market was going, just do the opposite of the individual investor. Ironically, this statement was popular at the same time that 91 percent of professional fund managers failed to beat the S&P 500 during any previous 10-year period.

Nevertheless, the system was set up to make you pay as much as possible for buying and selling stocks, and as long as you kept playing along, it appeared as if it would go on forever. The major brokerages were running the stock market game, and there was little chance they were going to play fair. It was their game, and the rules and regulations were on their side.

Contrast how retail investors were treated on Wall Street with the way institutional investors were treated. For nearly two centuries, institutional investors, including insurance companies, mutual fund companies, and banks, received favored treatment on Wall Street at the expense of retail investors. Institutional investors were charged extremely low commissions and were given access to detailed quote screens (when they became available) as well as opportunities to trade with each other before the market opened or after it closed.

This was the way the stock market worked, and it ran quite smoothly for nearly 200 years, that is, until October 1987, when the stock market experienced one of the biggest price declines in its history. The crash of 1987 exposed the extreme differences between institutional and retail investors. On that day, while larger institutional investors generally got their orders filled in a timely fashion, the orders of retail investors were ignored. More often than not, small investors heard nothing but busy signals when they tried to call their brokers. Even if their stockbroker got through to a floor broker (a market maker or specialist), the mar-

ket makers, according to the rules at the time, were under no obligation to fill the order.

In fact, that's what happened in 1987. Many market makers on the Nasdaq and specialists on the NYSE ignored the orders of retail investors, taking care of their major clients or themselves. By the time the pros got to the sell orders of retail investors, the market had reached an all-time low. Adding insult to injury, while individual investors counted their losses, the market makers and specialists, along with favored institutional investors, scooped up stocks at bargain prices. The pros used their superior knowledge about how the market worked to profit from the accounts of inexperienced, unsuspecting investors. It was not exactly what you'd call a level playing field. In fact, some pros made more money during that week than they had during their entire career.

DAY TRADERS VERSUS WALL STREET

Some good things did come out of the 1987 crash, however. The government insisted that regulations be changed to allow individual investors equal access to the markets. After all, if the retail investor lost faith in the stock market and refused to invest, there wouldn't be much of a stock market. The National Association of Securities Dealers (NASD), which controls the Nasdaq market, also took steps to upgrade the Small Order Entry System (SOES) so individual investors could buy and sell Nasdaq stocks electronically without having to go through a stockbroker. This electronic trading system was the first generation of equipment that gave individual investors the ability to independently trade Nasdaq stocks.

This was also the time that professional day trader Harvey Houtkin recognized that SOES allowed him to buy and sell stocks within the publicly advertised bid and ask price, emulating professional market makers and generating thousands of dollars in profits. As it turned out, Houtkin's scalping strategies were so successful that thousands of SOES machines were installed in day trading firms across the country, including his own.

The new rules forced market makers on the Nasdaq to execute an order once it was received from SOES. This allowed day traders to profit by buying and selling stocks for small ⅛- and ¼-point profits. At the time, it was relatively easy money. Houtkin used the rules and new technology to beat the market makers at their own game, and the pros hated him for it. In fact, they sarcastically called him and his fellow day traders "SOES bandits," although Houtkin said he thinks of himself as more like Zorro. Nevertheless, Wall Street has been at war with day traders ever since SOES was introduced, and there is no indication it will cease.

As a result of the 1987 crash and at the urging of the SEC, the NYSE grudgingly took steps to upgrade its order-routing facilities. A decade before, Congress had tried to encourage a fair and equitable market by creating the National Market System (NMS), which linked all the different markets and exchanges together. The idea was to find a way for the small investor to get access to the trading venues of the NYSE. In other words, the NMS was supposed to create a level playing field in which all investors had equal access to the same information, such as pricing information. It seemed like a fair idea, although many on Wall Street opposed it. Even then, there was talk of electronic trading systems without middlemen to handle orders, but that idea went nowhere fast.

Starting in 1978, the NYSE planned and eventually created the Intermarket Trading System (ITS), which linked the NYSE to all the regional exchanges. Although the original idea was to allow everyone easy and equal access to information on the NYSE and its regional exchanges, and the ability to trade stocks on any of these exchanges, what actually happened was that the ITS was used to trade only NYSE stocks. That's right, the ITS, backed up by numerous anticompetitive regulations, kept all current and future competitors away. In essence, the NYSE was in complete control of its own exchange and its most prized blue-chip stocks. The NYSE ingeniously turned a potential crisis, the 1987 market crash, into a very successful and surprising advantage.

After the crash of 1987, however, the NYSE and the Nasdaq went back to business pretty much as usual until 1994, when the

SEC caught several Nasdaq market makers blatantly ignoring customer limit orders, thus creating artificially high spreads between the bid and ask price of Nasdaq stocks. Although the SOES day traders had been legitimately buying and selling stocks between the spread for years, the market makers typically ignored them and instead took advantage of unsophisticated retail investors who were kept in the dark about what was happening with their orders.

For those who are new to the stock market, the accused market makers were rigging the price of stocks to keep the spread wide. They accepted only the most profitable customer orders (market orders) and essentially ignored all other orders (limit orders) on which they couldn't make a profit. This meant that your limit order, even if it was at a competitive price, would never be filled or displayed for others to see, costing customers millions of dollars.

When this scandal was uncovered, the SEC stepped in with new order-handling rules requiring professional Nasdaq market makers to publicly display all customer limit orders whether held on their system or not. No longer could professional market makers ignore limit orders that were placed between the bid and ask price.

As a result of the new order-handling rules, the spread between the bid and ask price of Nasdaq stocks narrowed, creating a fairer, more efficient pricing system. These rule changes also allowed the individual investor more opportunity and power to get the best prices. Although the rules still favored "the house," the stock market game was becoming a lot fairer.

The timing of the scandal couldn't have been worse because it occurred just as online investing was being introduced to the public. In 1994, when the scandal broke, there was only one online broker. A few years later, more than 100 online brokers scrambled for market share, driving the price of broker commissions from hundreds of dollars per share to less than $10. The online brokers claimed they could do everything a traditional broker did except tell you what to buy. Some of the largest Wall Street brokerages doubted that individual investors would ever choose to trade stocks on their own without the help of a stockbroker. That belief turned out to be a huge miscalculation.

Suddenly, the individual investor, who had often been ridiculed by the pros for years, had the attention of the brokerage community. With help from an apparently unstoppable bull market and the Internet, people flocked to online brokers, who were hungry to give individual investors the services they wanted at a reasonable price. In a way, it was Wall Street's biggest nightmare come true: millions of investors across the country going online to trade stocks without the help of a full-service stockbroker. Although some traditional full-service brokerages reacted quickly by opening their own online trading divisions, others aggressively fought the shift to the Internet, much to their detriment.

The new order-handling rules, the popularity and growth of the Internet, and a bull market convinced millions to try their hand at online investing. In the collective mind of Wall Street, anyone who doesn't use a stockbroker is a day trader. With that definition in mind, the electronic day trading revolution was born. Although it infuriated many on Wall Street, many day traders took advantage of the new order-handling rules to emulate the actions of market makers and specialists, some making huge profits. In fact, the possibility that you could make unlimited amounts of money day-trading stocks propelled the day trading culture into the open. Dozens of books were published teaching you how to cash in on this new trend. To many retail investors, day trading was an ideal way to increase their net worth. No longer would you have to rely on stockbrokers to tell you what to buy or sell.

It is no wonder many pros on Wall Street and elsewhere have such negative things to say about day traders. In the opinion of many pros, day traders are about the lowest form of life on the food chain, even though by definition day trading was exactly what most of the trading pros on Wall Street did for a living.

THE BATTLE WITH THE ECN

The new 1997 order-handling rules were primarily designed to spur competition among alternative trading platforms. In keeping with this idea, the rules allowed for the creation of electronic

communication networks (ECNs), based on the electronic communication model established by Instinet over 30 years ago. Just as Instinet allowed institutional investors to anonymously buy and sell stocks around the clock among themselves, the ECNs let the retail investor do the same.

After seeking and receiving approval from the SEC, the first ECNs, which operate as private companies, opened for business. The idea behind the ECNs was to privately match individual buyers and sellers without their having to go through a market maker or specialist to play with the order. ECNs really represent a pure auction market, much like an eBay for the stock market. For a cost of less than a penny per share on each side of the transaction, ECNs directly match buy and sell orders. Because ECNs take no position in their own accounts, as market makers and specialists do, there is no opportunity for price manipulation. They operate on bare minimum commissions, on fractions of percents of shares that are matched.

Although the quoted price and order size are made public in some of the ECN limit order books, the customer's identity is a secret. Anonymity is especially important to institutional investors that don't want their investment strategies or identity revealed to others when handled by a middleman on the floor of an exchange. The reason is that if other traders know of a large position being accumulated, they could try and buy in front of the order.

The ECNs also removed some of the barriers that prevented retail investors from receiving fair prices. The SEC found that many market makers quoted one price for institutional investors and another price for retail investors. The open platform of the ECNs allows the limit price of all participants—institutional investors, retail investors, market makers, and professional traders—to be publicly displayed.

Once again, it seemed like the first to discover the power of the ECNs were day traders, who used special software (Level II screens) that allowed them to specify who would handle their orders. As you can guess, they often directed their orders to ECNs, bypassing the middlemen and saving time and money. Day traders took advantage of the low commissions and faster execution speeds of the ECNs. To day traders, a minute is like a

lifetime. They don't have the time to wait 15 or 30 seconds while an order is passed to a middleman for handling.

In no time at all, more of the technologically superior ECNs were being built. Perhaps it was pressure from the SEC, but the Nasdaq helped speed up the proliferation of ECNs (now numbering 10) by sharing its automated quotation system with these new computer networks. This meant that ECNs were free to trade Nasdaq stocks, and they did. The NYSE, on the other hand, resisted any change in the way it did business, refusing to let any NYSE stocks trade anywhere but on the NYSE.

Once the door was opened for the upstart ECNs, it couldn't be closed. From zero market share a couple of years ago, it is now estimated that ECNs account for more than 30 percent of the volume being traded on the Nasdaq. This number is expected to increase as all the market participants fight for the orders of retail investors. ECNs continue to take away business from the market makers and specialists who make a living on Wall Street. When we talk about a war, this is the war we mean: Everyone is fighting for a piece of the billions of orders being traded every day on the NYSE and the Nasdaq Stock Market. On one side of the battle is a group of technologically advanced ECNs. On the other side are the NYSE, the regional stock exchanges, and the Nasdaq Stock Market. The battle lines have been drawn, and while you won't see any bullets, there are fatal implications for the losers.

THE BATTLE OVER AFTER-HOURS TRADING

It wasn't long before the battle over market share soon moved to the after-hours arena. If you thought that the battle over ECNs was fierce, it was nothing compared with that over after-hours trading. Because ECNs operate electronically behind the scenes and can literally process orders 24 hours a day, it was only natural they would position themselves for after-hours trading. To ECNs, there is no after hours, just a continuous 24-hour-a-day market with no ending or beginning. The goal is to grab as many orders as possible, and doing business after hours was a natural way to take more market share.

In those frantic early days of after-hours trading, it seemed pretty haphazard. ECNs were set up quickly, without any attempt to coordinate them with other ECNs, stock markets, or stock exchanges. Each ECN scrambled to sign up as many online clients as possible. To many, it was too much, too soon. "In my estimation, all of the players should have come into after hours at the same time," says Lee Korins, president of the Security Traders Association (STA), which represents 7,200 financial service professionals. "There should have been a coordinated start so that all clients could see what the best bids and offer were." Because there wasn't a central quotation facility in the beginning, the after-hours market was somewhat flawed and confusing to the typical investor.

Others were concerned about how quickly the ECNs grew, cutting into market share and challenging Wall Street's turf. The critics claimed that the ECNs were moving too fast with after-hours trading, which could erode investor confidence and result in an inferior product. Not true, say the ECNs. The ECNs claimed this was nothing more than the beauty of good old-fashioned competition, which is good for everyone, especially retail investors.

Tired of waiting for the NYSE and the Nasdaq to officially get involved in after-hours trading, the ECNs drafted a letter of agreement to hook together their networks. Because the NYSE and the Nasdaq were not rushing to create a centralized quote system, the ECNs would do it themselves. The idea was to give the individual investor one central location for the best bid and offer price, and the ECNs wanted the technology set up as soon as possible.

Unfortunately, the SEC was placed in the awkward position of trying to placate a number of different groups. The feeling of the SEC, which tried to remain neutral, was that the securities industry should create its own rules. The SEC didn't want to be in a position of having to tell the major market participants what to do. Chairman Arthur Levitt of the SEC supported investor choice in trading hours so long as investors were warned of the potential risks. On one hand, the SEC wanted to encourage a competitive market, giving individuals the best quoted price, fast execution times, and convenient trading hours. On the other hand, the SEC had to look out for the interests of Wall Street,

including the stock brokerages, broker-dealers, and others who make a living buying and selling stock to the public. Chairman Levitt didn't want to step into the center of capitalism and upset what competition ultimately brings: the best execution and service at the fairest price.

At the beginning, the NYSE and the Nasdaq chose to ignore the after-hours commotion, preferring to concentrate on Y2K (do you remember that?) and the move to decimalization. As often happens with competitive wars, the battle over after-hours trading was fought in the media. All the major players vented their frustrations in a series of newspaper and magazine articles on the advent of the after-hours market. Everyone took a side, although at least one well-known market maker took both sides.

Tons of negative articles on after-hours trading appeared, usually describing how dangerous it was for individual investors and concluding that it was unsafe at any time of the day or night. There were other warnings in the press, perhaps designed to keep potential traders away. Some warned that the after-hours market would create a nation of sleepless night traders. The conclusion from the pros was that after-hours trading will do nothing but confuse the retail investor. It's not something people need or want.

The three most common criticisms were fragmentation, high spreads, and wild price swings. Fragmentation means that customers could not be sure they were getting the best price for a security. When you have many different ECNs and stock exchanges competing against each other for the best price with no centralized location for the best bid and offer, fragmentation can occur, the critics warned. In other words, the price of a stock you see on one ECN may not be the same price on another ECN. The Nasdaq helped to alleviate part of this problem by agreeing to extend its centralized quote feeds to all parties until 6:30 p.m. EST; but after 6:30 p.m. EST, fragmentation still existed.

While the major players were making their positions known in the financial press, a funny thing happened. Retail investors ignored the critics and began to show up at night, indicating more than a passing interest in trading after hours. At first, the after-hours market was voluntary, and only a handful of online

brokerages showed any interest in allowing it. But after a while, the ECNs that concentrated on the after-hours market, primarily Instinet, Island, and MarketXT, saw a substantial increase in market share.

On Island ECN, for example, investors started 1998 by trading 1,000 shares a night, and within less than a year more than 8 million shares were being traded at night. All the ECNs, and also the Chicago Stock Market, the first regional exchange to offer extended-hours trading, showed increases in nightly trading activity. A lot of the credit for publicizing after-hours trading has to go to CNBC for its nightly "Extended Hours" feature, during which its financial anchors discuss the trading activity on the various ECNs, primarily Island and Instinet, and point out which stocks have been especially active.

Although the major players in the securities industry tried to ignore what was happening after hours, it was becoming much too popular to ignore. Some very powerful market players were upset with what Professor Junius Peake called the technological equivalent of a tsunami. After all, the ECNs were threatening to take money out of the pockets of market makers, specialists, and stockbrokers who weren't about to stay up half the night trading stocks. Many people, for a variety of reasons, didn't want to ever see after-hours trading become popular; probably the same people who tried in vain to discourage people from using the Internet.

The smaller broker-dealers were extremely concerned they would lose market share and profits to the larger brokerages, which could afford to pay overtime or hire new staff as well as cover the costs of doing business 18 hours a day. Some of the smaller firms across the country have only a couple of employees working at trading desks. To compete, they would have to hire additional staff, and so most are anxiously wringing their hands to see how many retail investors flock to the after-hours market.

Ironically, while many on Wall Street publicly complained about the dangers of after-hours trading, some of the top brokerage companies in the United States were either investing in or creating their own ECNs. Although many of the online brokerages had already been partners with ECNs, some were surprised when some of the most prestigious full-service brokerage compa-

nies on Wall Street agreed to allow after-hours trading. For example, Salomon Smith Barney was one of the first full-service brokerages to partner with an ECN, MarketXT, to provide customers with after-hours trading. And it wasn't just brokerage firms that were investing in ECNs. One major Nasdaq market maker that had often criticized the unreliability of ECNs was also taking an 18 percent share in an ECN devoted exclusively to after-hours trading.

On one hand, Wall Street was competing against the ECNs, and on the other hand, it was hedging its bets. If you can't beat them, some might say, you might as well join them. The major stock brokerage firms had resisted extending hours for years and now were rushing to join in.

Adding insult to injury, dozens of Wall Street executives quit their lucrative jobs and joined online brokerage companies or startup ECNs. The Wall Street shuffle, as we dub it, is still going on. A number of people have bet their careers to ensure that the after-hours market will be a hit with the public. For others, it was the chance to get in on something that is just beginning to shake Wall Street to its foundation.

To make things even more interesting, several ECNs have applied to be full-fledged stock exchanges. You might wonder why anyone would go through the regulatory nightmare of becoming an exchange. The reason is simple. The National Association of Securities Dealers (NASD), the governing group that regulates ECNs, also controls the Nasdaq. Therefore, the fate of ECNs is in the hands of the Nasdaq, their main competitor. That's right, ECNs are managed and regulated by their competition. By becoming stock brokerages, the ECNs would be free from the regulatory constraints of the NASD. Another advantage is that exchange status would allow investors to efficiently route their orders directly to an ECN. Now, you must first go through a broker to get your order filled.

In fact, Chicago-based Archipelago became the first ECN in the country to combine with a traditional stock exchange to provide investors access to the stocks listed on the NYSE, Nasdaq, and AMEX. In March 2000, Archipelago and the Pacific Stock Exchange made stock market history by announcing that they will file for approval with the SEC to become the first stock

exchange to go fully electronic. As a result of this partnership, the 78 floor traders on the Pacific Stock Exchange will have to find other jobs at the new virtual stock exchange.

Still, many ECN critics argue that ECNs are hardly regulated at all. As private companies, for example, ECNs can quickly and independently improve their technology without having to wait for self-governing committees or member firms to approve. According to these critics, the lean and mean ECNs have a huge competitive advantage over the NYSE and the Nasdaq even while under the umbrella of the NASD.

WALL STREET FIGHTS BACK

There was no way the NYSE and the Nasdaq were going to sit back and do nothing as these brash young upstart ECNs grabbed more customer orders. It took a while, but after watching silently from the sidelines, both the NYSE and the Nasdaq took steps to protect their franchises.

On the NYSE, there was some disagreement among member firms on the most effective way to win the battle with ECNs and the Nasdaq. In the past, the NYSE could rely on favorable regulations for protection. As noted earlier, these regulations were designed to help increase profits for member firms while stifling competition. For example, the NYSE relied on Rule 390 to keep the Nasdaq and competing ECNs from trading stocks in NYSE companies before 1979. This meant that the most prized blue-chip stocks, like IBM, could only be traded on the NYSE or regional exchanges linked to the NYSE. At the gentle but persistent urging of Chairman Levitt, Rule 390 was rescinded during the final days of 1999, and for the first time in the history of the market, both the NYSE and the Nasdaq are able to trade each other's stocks. Although the NYSE fiercely protected the way it was doing business for over 200 years, the competitive pressures slowly started to cause cracks.

At the urging of more aggressive member firms, the NYSE decided to take steps to change. One idea was to demutualize, in other words, to go public. One of the problems with self-

regulated institutions like the NYSE or the Nasdaq is that their boards consist of member firms that are often more concerned with the needs of well-paying institutional clients than with individual investors. Another problem is that decisions are sometimes made to increase profits for member firms without regard to what is best for the retail customer. The argument is that by becoming a for-profit exchange, the NYSE could make faster, more objective decisions, allowing the NYSE to successfully compete for customer orders. After all, the exchange that gives the customer the fastest service along with the best bid and ask price will bring in more customer orders. The Nasdaq also petitioned the SEC to become a private exchange so it could compete directly with ECNs.

The NYSE also began building a new billion-dollar facility across the street from its existing location. It is spending millions on a three-dimensional trading floor with the most advanced computer and technological gadgets. Although the NYSE has been slow to adapt to an electronic platform, it has begun to reinvent itself as the new and improved NYSE. It is even building an ECN within the NYSE containing an electronic order book with orders that will be displayed around the world. The goal of the NYSE is to lower investor costs, provide fast execution of orders, and provide superior connectivity. It has even taken steps to update the archaic ITS so that other market participants can benefit from a centralized market.

There is little doubt that Wall Street is fighting for its life as competitors like the Nasdaq and ECNs threaten to change the NYSE from a physical exchange, where people run or call out orders between trading desks, to the kind of electronic exchange that the Nasdaq and many European exchanges have become. Even the NYSE recognizes this battle is different. It will take more than favorable anticompetitive rules and regulations to survive. The NYSE is reinventing itself from a lumbering dinosaur clinging to the traditions of the past to what it hopes to be: a highly competitive, technologically superior exchange. It's true these changes didn't come about voluntarily. It was, in fact, the dual force of new technology and competition that forced the NYSE to reexamine and change itself. In the end, the NYSE will not only survive but also be healthier. That is the magic of competition.

The Nasdaq has also taken steps to compete more forcefully with the NYSE, its main competitor. The Nasdaq, which runs a quote display mechanism and allows other market participants to access these quotations, is working on improving its limit order book, perhaps even creating a super limit order book. One of the main purposes of the Nasdaq is to garner quotations from a number of fragmented places and consolidate them in one location. This allows everyone access to the quoted prices. The Nasdaq has slowly been extending its consolidated quote system so that all the market players have access to these quotes. In addition, the Nasdaq has taken aggressive steps to introduce its electronic systems to international markets. Perhaps because the Nasdaq was originally set up as an electronic exchange, it will be in a better position to adapt to the shift from a physical to an electronic market.

WHO IS GOING TO WIN?

It is impossible to predict who will ultimately win the war on Wall Street, and this war is expected to intensify before a winner is declared. The war between the ECNs, the NYSE, the Nasdaq, and the regional exchanges over after-hours trading will likely last well into the twenty-first century. The major players will compete fiercely for market share in the after-hours market.

Although many would prefer to hold onto the traditions of the past, change is inevitable. Often, people love to talk about how important it is to change as long as it doesn't affect them. As we move through the twenty-first century, Wall Street will be going through a dramatic transformation. The sudden acceptance of after-hours trading by nearly every traditional brokerage is one clue the game is going to be played differently. It doesn't matter whether Wall Street accepts it peaceably or kicking and screaming—many people believe that after-hours is an idea whose time has come.

In the end, we believe the real winner will be you, the retail investor, because increased competition lowers prices, improves service, and speeds up technology. Investors want equal and convenient access to the markets that the institutions have

enjoyed for years. The individual investor, however, has had the last laugh. Today's investor not only is more knowledgeable and sophisticated about how the market works, but is voting with his or her pocketbook. Many do-it-yourself investors are unwilling to pay exorbitant fees to stockbrokers and are switching to or signing up with online brokers. As a result of the increased competition among online brokerages, the retail investor is experiencing not only lower costs but more efficient service and faster order execution. You are no longer at the mercy of your friendly neighborhood stockbroker.

For the after-hours market to be successful, the exchanges need your business. After all, you provide liquidity, which is the lifeblood of the stock market. Without buyers and sellers, there is no market, after hours or otherwise. As long as people are buying and selling stocks, the brokers and professional traders are making money.

All the major players are holding their breath, wondering if you will turn on your computer, laptop, or wireless device after the regular market closes and keep trading. Although no one knows for sure what millions of online investors will do, we wouldn't have written this book if we didn't think you'd find after-hours trading profitable and convenient. Up to now, however, very few people knew much about it. The early indications are that after-hours trading will be a success. The answer is in the numbers, and the numbers show that retail investors in the after-hours market are trading millions of shares.

Even though in the past it was easy for unethical market makers to chisel retail customers out of millions of dollars from artificially high spreads and trading games, the time has come for a fair and open system, one in which all investors will benefit. We think the pros should play by the same rules as individual investors. The aim of nearly all the market participants is to create a transparent and competitive marketplace, where everyone has access to the same information at the same time. If a handful of market makers or specialists are still willing to take unfair advantage of individual investors, competitive pressures will eventually drive them away.

We don't particularly care who the winners are, as long as the needs of the retail investor are represented, and we think it is

about time this happened. If after-hours trading is what it takes to wake up the major players on Wall Street, so be it. Granted, it might not be a pretty sight if you are in the middle of this battle.

Nearly everyone agrees that the after-hours movement has a life of its own, and it is unlikely that anything is going to stop people from trading stocks when and if they feel like it. After-hours trading is what investors are asking for although it is still unclear how much actual demand there will be, especially if a bear market is waiting around the corner. Nevertheless, that won't stop experienced short-term traders and long-term investors from taking advantage of this new market. As long as people are buying and selling stocks, you can make money, no matter what the market environment. The after-hours market simply provides you with a convenient time and place to trade.

LET'S GET STARTED!

Now that we've given you a little historical perspective about how after-hours trading began, it's time to get down to business, that is, to teach you everything you need to know about after-hours trading. By the time you finish this book, you will know quite a lot about the online brokerages that allow after-hours trading and the ECNs that work behind the scenes to match your order. You'll also be alerted to some of the important issues and risks concerning after-hours trading, and how to deal with them. Most importantly, you will have learned strategies that will help you profit from one of the newest games being played on Wall Street. In the end, we think you will find after-hours trading fascinating and fun.

3

THE ECN: LEVELING THE PLAYING FIELD

By now, you are probably eager to open up an online brokerage account and get your feet wet with after-hours trading. Before we show you how to trade after hours, we'd first like to introduce you to one of the most exciting technological stock trading advances of the last decade: electronic communication networks. As we mentioned earlier, it was the Internet that made ECNs possible. In this chapter, we will show you how ECNs are changing the way stocks are traded, the key components of an ECN, and a brief description of each part.

We can thank Instinet for creating the technological framework that made ECNs possible. The idea behind the ECNs is to electronically match buy and sell orders as quickly and inexpensively as possible. Unlike earlier ECNs, which only matched the orders of institutional investors, the ECNs of today match all orders, those of retail investors and day traders as well as those of institutional investors, without any human interaction. It is an equitable first-come, first-served system that gives no preference to the size of the trade. It is true, however, that the ECNs of today were designed to cater to the needs of the retail investor.

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Ideally, ECNs work in conjunction with the various stock exchanges and the Nasdaq to provide liquidity and competitive prices for customers. Because ECNs compete with market makers and specialists for customer orders, the spreads between the bid and ask have narrowed. Unlike professional market makers and specialists, ECNs do not profit from the spread. Rather, they make their money by charging a very small per-share or per-transaction fee. ECNs work behind the scenes with many of the online brokerages to process your order for a fraction of the cost.

THE ADVANTAGES OF THE ECN

As we briefly mentioned in Chapter 2, there are a number of advantages to using an ECN to place your order. The most important is that you will get better order fills by paying only the price that you want to pay. If you see a stock for a price that you want, you simply enter an order at that limit price and you'll get an instantaneous match. With a broker, it can take quite a while to execute your order. By using ECNs, you eliminate many of the steps a broker must take, resulting in faster order executions and better price fills.

Because there is almost no human interaction, the cost of filling your order is reduced, which allows your brokerage to charge lower commission rates. Although ECNs are indeed "for-profit" businesses, they do not make money on the spreads of the stocks. Instead, they make money by charging brokerages a fixed fee for each order that is executed on their ECN. This cost is absorbed by the brokerage firm and covered by the commission rates they charge.

It is important to remember that you can only get your order filled on an ECN if there is someone else on the other side of the transaction that is willing to buy or sell to you at the price you specify. That is, your order must be marketable. Otherwise, your order will be routed to a market maker or specialist during the regular day, or sit in a queue in the after-hours session.

HOW AN ECN WORKS

Let's take a closer look at what actually happens behind the scenes when an ECN matches your order. Suppose that you decide to place an order with your online brokerage to buy 500 shares of Microsoft at a price of 65¼ in the after-hours trading session. When you press the send key, your order is routed to an ECN. The ECN automatically and instantaneously tries to match your order with a corresponding sell order. If there is no immediate match, your order will be displayed in the limit order book. This book displays all buy and sell orders for a particular stock in the order in which they are received. Later, if another investor sells 500 shares of Microsoft at 65¼ on the same ECN, your order will be instantly matched. The result is that you will get your buy order filled and the other person will get his or her sell order filled, all without any human interaction. Not only does this give you better order fills, but it also gives you much quicker order confirmations.

HOW DOES THE ECN LIMIT ORDER BOOK WORK?

The limit order book is an extremely helpful tool that you must understand how to use if you are going to be an after-hours trader. Although many people trade after hours, not everyone is aware of the many benefits of using the various ECN order books for after-hours trading. In fact, the order book is one of the most important tools for anyone trading in the after-hours market. If you have used a Level II screen (the software many day traders use to trade stocks), then the order book will look familiar. One of the reasons we like the order book is that it openly displays everyone's orders. Without the order book, you are often trading in the dark without a clue of the best price. It is difficult to negotiate for the best price when you have no idea what that price is.

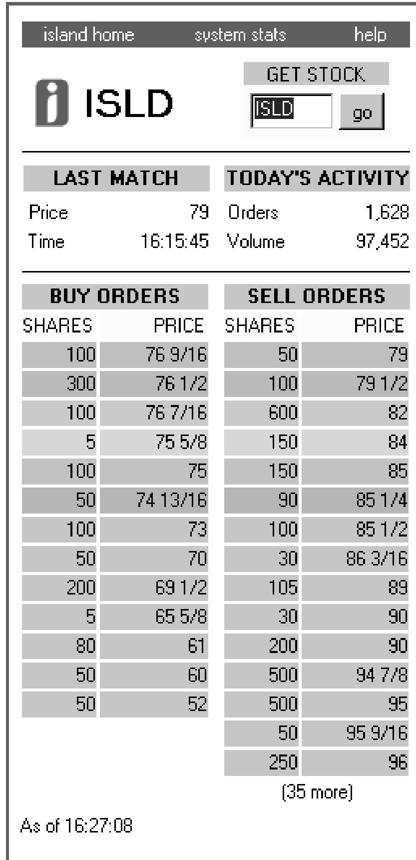
The limit order book tells you exactly how many limit orders there are for each stock and the price and quantity of each order. The order book is the electronic version of what the market makers and specialists use to keep track of orders. The order book also allows you to plan a strategy based on the orders of other traders. When the major market players talk about the importance of market transparency, the order book is what they have in mind. Market transparency corresponds to an open system where all market participants have full and equal access to the bid and ask prices. We think it is interesting that, because the order books are available in the after-hours market, you sometimes have more price information during the after-hours market than during the regular market.

Figure 3-1 shows what a limit order book looks like in electronic format. As you can see from the figure, an order book is divided into two sections, one for buy orders and one for sell orders. Each individual buy and sell order for a particular stock is included in the order book. On the left side of the order book are all the buy orders. They are listed individually in descending order from highest to lowest price (on buy side). The size of the order is not given preference. Each order is listed in the order in which it is received, that is, first come, first listed.

Let's say, for example, that the highest price on the buy side of the order book is $76\frac{9}{16}$. This is the highest price that someone is willing to pay for the stock at that particular moment. It is also known as the "best bid" or "inside bid" price. This means that someone on this ECN is willing to buy this stock for $76\frac{9}{16}$ per share. Conversely, this also means that if you owned this stock and wanted to sell it, this is the best price you could receive.

As mentioned earlier, each individual buy order is listed in descending order from highest to lowest. The prices on the left side gradually drop in price until you reach the bottom of the page. The lowest price on the left side is the price that someone is willing to buy or bid for the stock. Let's say the lowest price is 52. Keep in mind there might be dozens or hundreds of other orders that are even lower than this price but aren't displayed. The lower prices mean that people are hoping the price will drop so they can get their orders filled at bargain prices.

FIGURE 3-1 *Island order book*



island home | system stats | help

ISLD

GET STOCK: ISLD go

LAST MATCH		TODAY'S ACTIVITY	
Price	79	Orders	1,628
Time	16:15:45	Volume	97,452

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
100	76 9/16	50	79
300	76 1/2	100	79 1/2
100	76 7/16	600	82
5	75 5/8	150	84
100	75	150	85
50	74 13/16	90	85 1/4
100	73	100	85 1/2
50	70	30	86 3/16
200	69 1/2	105	89
5	65 5/8	30	90
80	61	200	90
50	60	500	94 7/8
50	52	500	95
		50	95 9/16
		250	96
		(35 more)	

As of 16:27:08

From your perspective, if you owned the stock and wanted to sell it, the best price you could get at that moment would be $76\frac{9}{16}$. If you put in a limit order to sell your shares of stock for $76\frac{9}{16}$, it would likely be matched immediately, depending on how many shares you owned. Although people are willing to buy the stock from you for 52 or lower, as a seller, you are only interested in the highest price, which is at the top of the left side of the order book.

Now let's look at the right side of the order book, which contains all the sell orders. This side is also known as the "ask" or

"offer" side. On this side of the order book, each individual sell order is listed in ascending order from the lowest to the highest. The prices on the right side gradually rise in price until you reach the bottom of the page.

Let's say the lowest price on the right side of the book is $79. This is the lowest price that someone is willing to sell the stock for at that particular moment. Keep in mind there may be dozens or hundreds of other orders that are higher than this price. The higher prices mean that people are hoping the price of the stock will rise so they can get it filled for the highest possible price. Conversely, this also means that if you wanted to buy this stock, $79 is currently the lowest price you could get.

From your perspective, if you wanted to buy this stock, the best price you can get at the moment is $79 a share. If you put in a limit order to buy it at $79, it will probably be matched immediately, depending on the number of shares. Although people would sell you the stock for much higher prices, $79 is the best offer you have at this moment. You are only looking at the lowest price, which is on the top of the right side of the limit order book.

Many of the ECNs have some form of viewable electronic limit order book, including Island, MarketXT, Archipelago, Instinet, and REDIBook. However, how you access the data for each order book varies. Some ECNs require you to download proprietary software before being able to view their order book. Others allow you to view their order book through the Internet, with no additional software required.

We have also successfully used a wireless Palm Pilot to view the Island limit order book while sitting at the beach or eating at a restaurant. Although we don't recommend that you routinely mix business with pleasure, wireless technology allows you to trade stocks with the limit order book in any location. Island was the first ECN to allow its limit order book to be displayed on a wireless device such as the Palm Pilot, but we believe other ECNs will certainly follow. We believe that wireless technology will one day be as popular as cellular phones. The combination of the Internet, wireless technology, and after-hours trading will be too powerful for most people to resist.

Depending on the ECN, the amount and type of data displayed in the limit order book also vary. Some ECNs can provide

you with a host of information, including intraday trade history such as time and sales price, average order size, average buy price, and average sell price. Others simply provide you with basic information, such as the bid or offer price, the size of the order being bid or offered, and the time and price of the last order match.

Regardless of the additional information displayed, remember that the orders displayed reflect only those orders that are placed on that particular ECN. For example, if the best bid price for a particular stock is 48½ on Island, the best bid price on ARCA, Instinet, MarketXT, or any of the others may vary. Remember, too, that ECNs are independent of each other, and so you may need to view separate order books for each of the ECNs you use. As of now, there is no single order book that displays all orders for every ECN altogether in one place, although some ECNs do make it possible for you to see the order books of other ECNs.

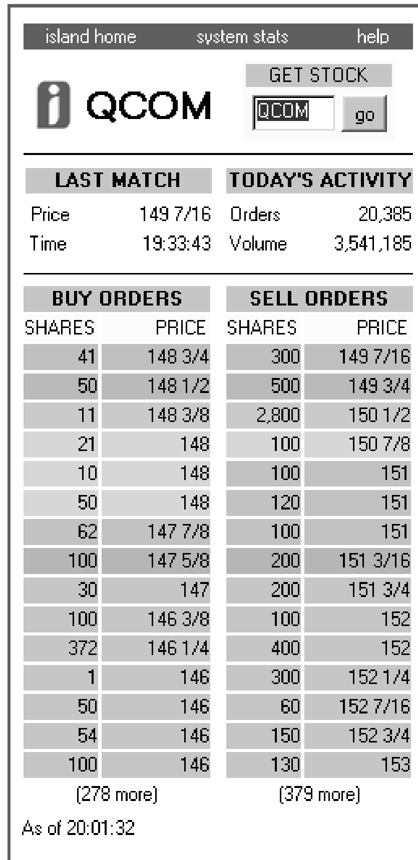
UNDERSTANDING THE LIMIT ORDER BOOK

Since Island has achieved strong after-hours liquidity, its limit order book, which is also used in our example above, is a good representation of after-hours price movement, as well as market-hours price movement, for any Nasdaq stock. To help you understand what the order book can do for you, we will walk you through using the Island order book, one of the most popular and, in our opinion, one of the easiest to understand. Let's refer to the screen print for Qualcomm, shown in Figure 3-2, to help you understand how to read the data in the order book.

LAST MATCH

This section shows you the exact price and time of the last order for Qualcomm that was matched on the Island ECN. In this case, the price of the last trade was 149 7/16. The time the order was executed was 19:33:43 (7:33 p.m. EST). Notice that the best price on the "Sell Orders" side was also 149 7/16. This most likely means that the last order was executed at or near the offer price of the stock.

FIGURE 3-2 *Island Qualcomm stock*



island home | system stats | help

QCOM

GET STOCK

QCOM go

LAST MATCH		TODAY'S ACTIVITY	
Price	149 7/16	Orders	20,385
Time	19:33:43	Volume	3,541,185

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
41	148 3/4	300	149 7/16
50	148 1/2	500	149 3/4
11	148 3/8	2,800	150 1/2
21	148	100	150 7/8
10	148	100	151
50	148	120	151
62	147 7/8	100	151
100	147 5/8	200	151 3/16
30	147	200	151 3/4
100	146 3/8	100	152
372	146 1/4	400	152
1	146	300	152 1/4
50	146	60	152 7/16
54	146	150	152 3/4
100	146	130	153
(278 more)		(379 more)	

As of 20:01:32

TODAY'S ACTIVITY

This section shows the total number of orders matched on Island so far that day, from opening until the present time. In this example, you can see that there were a total of 20,385 QCOM orders executed that day. The number that is listed represents only orders that actually got matched, not orders that were placed and never filled. You will also see a figure of 3,541,185 listed for

"Volume." This number represents the total volume of the 20,385 orders that were matched on Island that day.

BUY ORDERS

Here you will see the price and quantity for each buy order currently in the order book. When you place an order to buy a stock on Island at or below the current best buy price displayed, your order immediately gets added to the book and is displayed here. If you look at the current best bid price, you will see an order to buy 41 shares at a price of 148¾. If you had shares that you immediately wanted to sell on Island, this would be the best price you could get, but up to only 41 shares. If you had more than 41 shares to sell at 148¾, you would only get a partial fill on your sell order because there are only 41 shares being bid for at that price. You would have to go to a lower level until your entire order was filled.

Below the best bid price of 148¾, you will see many other buy orders listed. Notice that the lowest bid price shown is for 100 shares at $146. However, notice that it says "278 more" in parentheses at the bottom of the buy orders. This indicates that there are 278 additional, live buy orders that are listed at a price below the 100 shares at $146. As you may have noticed, only the top 15 buy orders are displayed in the order book. Each time a buy order disappears, due to an order either getting filled or getting canceled by an investor, one more additional buy order moves up to fill in that gap. Therefore, the top 15 live buy orders will always be displayed, in descending order.

SELL ORDERS

This section is nearly identical to the "Buy Orders" section, except that everything is reversed. In this case, you will notice that the best sell price is 300 shares at a price of 149⁷⁄₁₆. That means that if you immediately wanted to buy QCOM on Island, the lowest price you could buy at would be 149⁷⁄₁₆ for up to 300 shares. Beyond the sell order at 149⁷⁄₁₆, you can see the prices

increasing. Instead of the prices descending as they do on the buy side, they are ascending from lowest to highest. You will also see that there are 379 more live sell orders beyond the top 15 that are displayed.

WHAT YOU SHOULD KNOW ABOUT ECN ORDER BOOKS

FIRST COME, FIRST SERVED

When you place a trade on an ECN, it is important to remember that all orders are entered into the limit order book in the order in which they are received. For example, if you place an order to sell your shares of QCOM at $151 and there are already three other orders in the book at the same price, your order will be displayed as the fourth sell order behind the other three sellers at $151. Your order would not get filled until the three orders in front of you get filled. Buy and sell orders are executed on a first-come, first-served basis.

PARTIAL FILLS

You also need to be aware that partial fills may occur when trading on an ECN, because you will only get filled for the number of shares the limit order book is showing. Also, once an order is completely filled, it disappears from the book. As an example, look at the buy side, or left-hand side, of the QCOM screen shot in Figure 3-2. Let's imagine for a moment that all the orders to buy at a price above $148 are not there. In other words, assume that the highest buy price is $148. If that were the case, you would then see three separate buy orders for a combined total of 81 shares at $148. If you were to place an order on Island to sell 100 shares at $148, you would immediately get filled for only 81 shares. The three sell orders at that price would disappear from the book. The remaining 19 shares of your original 100-share buy order, however, would now show up as the best offer (or sell

price). You would see 19 shares offered at 149⁷⁄₁₆, and the best bid would become the next price level down, which is 147⅞ in this case. This is how partial fills occur. You need to make sure that the quantity you are trying to buy or sell on the ECN is currently available at the price you are willing to pay or receive, and remember that orders are matched on a first-come, first-served basis. Otherwise, you will get only partial fills, which can be frustrating and discouraging.

LARGE SPREADS

Remember that you might be subject to large price spreads when you place an order on an ECN. Notice on the QCOM sample that there is a ¾-point spread between the current best buy price and the best sell price. However, with some stocks, it is not uncommon to have a several-point spread after hours.

WHAT HAPPENS IF THERE IS NO MATCH?

It is important to realize that you can only get your order filled on an ECN after hours if there is someone on the other side of the transaction who is willing to buy or sell to you at the price you specify. That is, your order must be marketable. But what happens if your order is not marketable, that is, there are no matching transactions? We'll try to explain.

Suppose you place an order to sell 300 shares of AMAT on Island at a price of 89¼. Your order is then sent out to the Island order book to look for an immediate match. Unfortunately, the highest price anyone is willing to pay for that stock is 89¹⁄₁₆, and so there is no match. Instead, your order gets placed on the sell side of Island with a price of 89¼, where it will remain unfilled until a matching order comes in. In fact, if the ECN doesn't have sufficient liquidity, your order may very well not be matched or executed at all. Your odds for a match improve, of course, if the ECN has a large number of orders or if your ECN can look at other ECNs for orders.

ABOUT THE CURRENT PLAYERS

Due to the intense competition for market share among the ECNs, the players are continually—and rapidly—changing. For now, the 10 ECNs that are vying for market share are Instinet, Island, Archipelago, REDIBook, MarketXT, NexTrade, Strike, Attain, BRUT, and Bloomberg Tradebook.

Approximately 30 percent of Nasdaq's average daily volume is already being traded through ECNs, and this percentage is expected to increase. Instinet, Island, and Archipelago make up a significant portion of the trading volume, but MarketXT and REDIBook are certainly gaining ground, and other ECNs are beginning to make progress as well.

Although all these ECNs accomplish the same basic goal of matching buy and sell orders electronically, there are some differences in how each one operates. Some ECNs cater to the retail investor, while others are more suitable for direct-access traders, day traders, or institutional investors. Instinet, for example, was developed more than 30 years ago specifically for the benefit of large institutional investors that wanted a way to trade anonymously via a neutral broker. Trading is allowed before the market opens, after the market closes, and also during regular market hours.

INSTINET (WWW.INSTINET.COM)

Instinet, the world's largest agency brokerage, operates as an ECN in the Nasdaq. It is also the largest in terms of average daily trading volume. For example, it routinely trades over 487 million shares in the United States each day, with 29.4 million in non-market hours. In addition, it presently trades about 20 percent of the Nasdaq's average daily volume and also trades a significant portion of NYSE shares daily. The firm provides its services in 40 different global markets and holds memberships in 18 different exchanges throughout North America, Europe, and Asia.

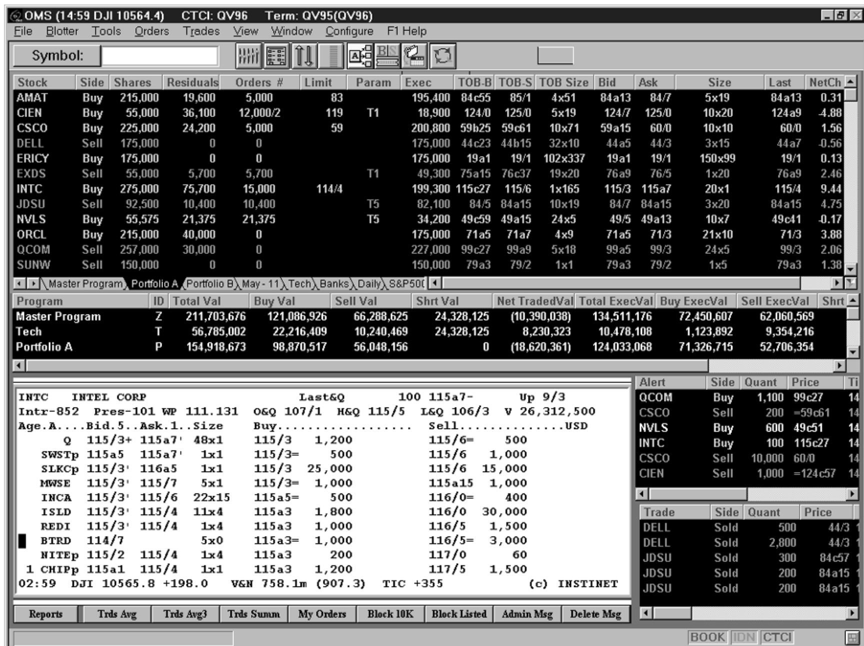
Although originally restricted to institutional investors like mutual fund managers, insurance companies, and banks, Instinet recently announced plans to allow individual retail investors to

use its services. Extended-hours trading with Instinet is currently being done through the online brokerage E*Trade, as well as through day trading brokerage firms that offer direct-access trading software. Instinet requires the use of its own dedicated Instinet terminal to view its limit order book. Unless you are a major brokerage firm or financial institution, the terminals are beyond the budget of most retail investors. A listing of the most active Instinet stocks, both Nasdaq and NYSE, can be viewed daily on its web site. Figure 3-3 shows a screen shot of the Instinet limit order book.

ISLAND (WWW.ISLAND.COM)

Island ECN, managed by after-hours advocate and CEO Matthew Andresen, began matching orders on the Nasdaq Stock Market in January 1997. One reason we are personally fond of Island is that

FIGURE 3-3 *Instinet limit order book*



it was the pioneer that started the ECN revolution. Island has grown quickly since its inception and currently boasts more than 280 subscribing brokerage firms around the country, including Datek Online Brokerage Services, of which Island is an affiliated company. On average, Island trades over 200 million shares on the Nasdaq market, which equates to roughly 12 percent of the Nasdaq's average daily volume. Island often averages over 12 million shares in the extended-hours trading sessions, which includes the premarket as well as after hours. It is second only to Instinet in trading volume.

Island holds the distinction for being the first ECN to publish its volume information publicly. If you go to its web site, you can view the daily Island trading volume data for the past year. Like Instinet, it also has a screen that shows you the top 20 most active stocks on Island at any given time (see Figure 3-4).

Island has gained enormous recognition over the past few years, and with good reason. Because so many brokerage firms subscribe to it, there is typically a lot of liquidity on Island ECN for any Nasdaq stock. This is especially important to night traders who rely on high liquidity to enter and exit a position quickly.

In addition, Island was the first ECN to display its limit order book, which as we explained above, shows every open order that investors have entered at the various buy and sell prices. This is a useful tool because it allows you to see, among other things, the true strength or weakness of a stock based upon the share size, quantity, and spread of each order in the order book. As we mentioned earlier, Island was also the first to put its limit order book on wireless devices such as the Palm Pilot.

ARCHIPELAGO (ARCA) (WWW.TRADEARCA.COM)

Behind Instinet and Island, ARCA is the third largest ECN in terms of average daily volume of shares traded. Formed in December 1996, ARCA is very well known in the day trading community because it is widely used by direct-access trading firms across the country. One feature sets ARCA apart from the rest of the ECNs, however: the ability to match orders not only

FIGURE 3-4 *Island top 20*

ISLAND REAL TIME AFTER-HOURS ACTIVITY SUMMARY

click here for Island full-day activity summary

VOLUME	ORDERS ENTERED	SHARES ENTERED
3,074,070	34,612	22,970,115

#	STOCK	SHARES TRADED	LAST TRADE PRICE	LAST TRADE TIME	ORDERS ENTERED	SHARES ENTERED	LAST ORDER TIME	OPEN ORDERS
1	PARS	533,282	8 11/32	19:59:22	2,302	1,847,785	19:58:20	152
2	CRRS	258,013	1 7/32	19:55:43	589	819,498	19:59:50	87
3	EILL	238,525	1 1/2	19:51:52	347	615,461	19:56:32	15
4	CXSN	236,151	6 3/8	18:21:23	239	673,944	19:54:57	26
5	VISX	215,013	18 11/32	19:58:54	1,735	1,133,370	19:59:25	175
6	EFCX	163,303	16 3/4	19:58:44	830	618,231	19:57:39	44
7	ENBXC	139,520	35/64	19:35:00	65	191,639	18:32:11	62
8	PPRT	102,808	2 31/32	19:55:47	281	389,220	19:58:29	55
9	COPY	80,553	2 1/2	16:27:54	85	172,463	18:44:52	60
10	BIKR	56,069	29/32	19:40:32	128	351,238	19:46:52	75
11	ITEC	55,895	1 13/32	19:55:40	87	202,593	19:51:45	464
12	DAWK	41,352	3	19:53:25	127	157,416	19:47:37	86
13	BEAS	40,907	144	19:47:19	985	175,440	19:59:30	119
14	VASO	40,806	3 1/4	19:56:44	158	168,888	19:59:48	63
15	LCAV	39,184	4 5/8	19:57:11	88	81,950	19:54:00	62
16	NEXL	22,653	7 3/8	19:49:45	121	81,759	19:42:16	80
17	MSFT	21,967	93 15/16	19:48:32	259	131,406	19:59:34	591
18	CYTO	19,166	15 7/8	18:36:50	110	69,398	19:58:17	144
19	ORCL	19,121	59 5/16	19:59:25	208	85,326	19:46:30	378
20	ODETA	19,071	25 1/2	19:59:52	213	76,085	19:58:46	18

within ARCA's own network, but also to other ECNs and market participants. Here is how it works.

When you send an order to the ARCA ECN, the system checks to see if there is an immediate match within the ARCA network. If there is a match, your order is quickly executed. However, if there is no match at the price you set and another ECN can match your order, the trade will be routed to that ECN for execution. If that order is not marketable, it remains as an order in the ARCA book and will be filled when a match is found.

ARCA is also one of the few ECNs (along with Island and MarketXT) that has an "open" order book, which means you can view all the ARCA orders over the Internet even if you don't have an account with ARCA. We also like the fact that ARCA displays not only its own orders, but the orders of the other ECNs as well. For this reason, ARCA refers to its limit order book as an "integrated" order book (see Figure 3-5).

The nice thing about ARCA's automatic order routing is that the technology is so advanced, your order is automatically routed to the market maker that has a history of the best percent-

FIGURE 3-5 *Archipelago limit order book*

Symbol: MSFT Update Top Five

MMID	BID	SIZE	TIME	MMID	ASK	SIZE	TIME
ISLAND	99 29/64	1500	10:12	ARCHIP	99 19/32	200	10:12
ISLAND	99 113/256	900	10:12	ARCHIP	99 5/8	500	10:12
ISLAND	99 3/8	500	10:12	ARCHIP	99 5/8	500	10:12
ISLAND	99 5/16	800	10:11	ISLAND	99 11/16	500	10:12
ISLAND	98 13/16	100	10:12	ISLAND	99 3/4	3381	10:12
ISLAND	98 3/4	1500	10:12	ISLAND	99 13/16	50	07:52
ISLAND	98 1/2	2700	10:11	ISLAND	99 7/8	1889	10:10
ISLAND	98 7/16	500	10:04	ISLAND	99 15/16	238	10:10

age of order fills based on time and size shown. ARCA has named this technology "SmartBook." It is nice because you aren't limited to getting order matches only within ARCA's network. In addition, it automatically figures out the best order route. If you prefer, ARCA will also let you preference a specific market maker. ARCA also allows you to display only a portion of your order if it is extremely large.

Archipelago made historic news when it announced that it will combine with the Pacific Stock Exchange to become the first fully electronic national stock exchange. This will allow Archipelago to trade the stocks of the NYSE, AMEX, and Nasdaq. As a result, the two trading floors of the Pacific Stock Exchange will be phased out, creating what Archipelago calls a "virtual marketplace."

REDIBOOK (WWW.REDI.COM)

Although Instinet, Island, and Archipelago are the three top ECNs as far as trading volume is concerned, the order volume on REDIBook ECN is also growing. Much of the growth is due to the commitment of its major partners, which represent a vast array of retail brokers. Owned by Spear, Leeds and Kellogg, REDIBook consists of a suite of direct-access trading tools known as REDI. These include a web-based trading platform, a wireless trading platform, news and screening software, and the REDIBook ECN. See Figure 3-6 for a screen shot of the REDIBook limit order book.

Just like ARCA, REDIBook has the ability to go outside its internal network to execute orders. First it looks for a match within the REDI network, but if no match is found, it sends the order to the market maker with the best bid or offer.

Another advantage of REDIBook, like ARCA, is its ability to hide the true size of an order. For example, if you are trying to buy 10,000 shares of a stock, REDI's software allows you to display only a portion of your order. If you do not want other market players to know you are accumulating (or selling) a large position, this is a helpful feature. REDI was also the first ECN to extend its trading hours until 10:00 p.m., which we predict will one day be the industry standard.

FIGURE 3-6 *REDIBook limit order book*

% Gain				
Sym	Last	Chg	% Chg	Vol
WTRS	26 1/4	+13 3/8	103.8	3,800
DURAW	3/4	+3/8	100.0	11,000
NOIZ	20 3/8	+9 7/8	94.0	36,910
MFCO	15 5/8	+7 1/2	92.3	6,500
SCCO	1 3/4	+13/16	86.6	14,300
AMLJ	6 13/16	+3	78.6	54,900
JMARW	9 1/2	+3 7/8	68.8	30,900
FLSC	3 7/32	+1 9/32	66.1	300

% Loss				
Sym	Last	Chg	% Chg	Vol
ACRN	1 1/2	-3/8	-20.0	200
QNTS	38 7/8	-9 3/8	-19.4	54,500
ALHY	5	-1 3/16	-19.1	1,000
SKYC	28 13/16	-6 1/8	-17.5	29,180
CNXT	96 7/8	-18 11/16	-16.1	291,899
XNVA	3 15/16	-3/4	-16.0	1,940
NSIL	28 1/2	-5 3/8	-15.8	1,046
SCAL	43 1/4	-7 7/8	-15.4	17,500

Most Active				
Sym	Last	Chg	% Chg	Vol
ORCL	69 11/16	-7/8	-1.2	1,445,203
MSFT	88 3/8	-2 15/16	-3.2	1,090,618
INTC	108 1/2	-4 11/16	-4.1	838,543
CSCO	128 5/16	-4 7/16	-3.3	644,789
DELL	39 9/16	-1 5/8	-3.9	623,618
WCOM	44 13/16	-3/16	-0.4	616,036
COMS	79 5/8	-7/8	-1.0	563,325
APGR	14 1/64	+2 29/64	21.2	465,090

Totals			
Open		Executed	
Orders	4,916	Orders	80,454
Shares	4,368,593	Shares	36,483,636
Executed			
Today		Tonight	
Orders	80,454	Orders	0
Shares	36,483,636	Shares	0

Top			
39 9/16	200	39 7/8	10
Bid		**Ask**	
39 9/16	200	39 7/8	10
39 7/16	500	40 7/8	1,300
39 3/8	500	40 7/8	1,000
39	2,000	41	1,500
38 1/2	500	41	500
38 3/16	3,400	41 1/8	2,000
38	100	41 5/16	3,400
38	100	41 3/8	3,000
38	400	41 3/4	2,000
		42	300
		43	500

Last	
Time	12:24:19
Price	39 9/16
Size	400
Today	
Close	41 3/16
Change	-1 5/8
Volume	623,618
Tonight	
Close	
Volume	0

Symbol: DELL — DELL COMPUTER CORP — Today / Tonight — Details / Summary

00@39 9/16 — Buy DELL 1000@39 9/16 — Sell DELL 20@39 7/8 — Buy DELL 500@3
1000@39 129/256 — DELL 100@39 1/2 — DELL 500@39 9/16 — DELL 400@39 9/16

MARKETXT (WWW.MARKETXT.COM)

Unlike the other ECNs, which are open during regular trading hours, MarketXT is only open during the premarket and post-market hours. In fact, the sole purpose of MarketXT is to facilitate after-hours trading. Headed by Michael Sanderson, former CEO of Instinet Corporation, MarketXT is designed primarily for trading by the retail investor. MarketXT is improving its trading volume based upon its partnerships with an ever-growing number of retail brokerages.

Formerly known as Eclipse Trading, MarketXT was founded in 1997 by two former SEC lawyers. The founders spent over 2 years designing MarketXT to meet the needs of the after-hours retail investor. The fact that MarketXT was geared to the individual investor is what separates MarketXT from its competitors.

Like most ECNs, the only way you can access MarketXT is to have an account with a brokerage firm that subscribes to it. Also, MarketXT allows customers to trade only a limited number of Nasdaq and NYSE stocks, although the list is growing. MarketXT actually encourages customers to send e-mails requesting that specific stocks be added for trading.

Like Island and ARCA, MarketXT also has an open order book that can be viewed at its web site (see Figure 3-7). Like most of the other ECNs, it is updated automatically. MarketXT is also extending its hours of operation, allowing a premarket session beginning at 6:00 a.m.

THE OTHER ECNS

The remaining ECNs, NexTrade (www.nextrade1.com), Strike (www.strk.com), Attain (www.attain.com), BRUT (www.ebrut.com), and Bloomberg Tradebook (www.bloomberg.com), are currently not as liquid as the ECNs discussed above. These ECNs require some type of proprietary software and, therefore, are not usually viable alternatives for the retail investor, although many day traders may be familiar with them. Because these ECNs are less liquid than the older and larger ECNs, it's understandable that NexTrade's CEO is one of the promoters of the after-hours supernetwork, where all buy and sell orders for after-hours trading would be consolidated in one location. In fact, this may be one of the only ways that these smaller, less liquid ECNs will be able to survive without merging or consolidating.

HOW YOUR ORDERS ARE ROUTED

Now that you have been introduced to the players in the ECN game, we want to take you behind the scenes to help you to understand exactly what happens to your order. In the past, aver-

MarketXT

DOW	9811.24	-135.89	-1.37%	4:30PM	S&P 500	1359.15	-24.47	-1.77%	4:59PM
NASDAQ	4706.63	-200.61	-4.09%	5:16PM	NIKKEI 225	19141.84	-48.09	-0.25%	4:33PM

LU 67 3/8 ▲ 1/8 SUNW 90 ▲ 2 5/8 GERN 43 3/4 ▲ 5 5/8 INTC 120 ▲ 2 1/8 MSFT 96 ▲ 7/8 PCLN 94 15/16 ▼ 1/16 MarketXT MOST ACTIVE as of 3/14/00 8:00:44 PM ET

HOME
QUOTES
MOST ACTIVE
STOCKWATCH
STOCKS OFFERED
MARKET NEWS
HELP
ABOUT MARKETXT
SITEMAP

MOST ACTIVE | STOCK WATCH | FLOATING MONITOR

MARKETXT Most Active

SYMBOL	LAST	CHANGE	VOLUME
ORCL	83 7/8	+6 3/4 (+8.75%)	38,206
IFMX	20 1/8	+1 1/4 (+6.62%)	6,400
HET	17 3/8		3,800
AOL	62 1/2	+1 (+1.63%)	3,096
LU	67 3/8	+1/8 (+0.19%)	3,000
SUNW	90	+2 5/8 (+3.00%)	2,950
GERN	43 3/4	+5 5/8 (+14.75%)	2,650
INTC	120	+2 1/8 (+1.80%)	2,630
MSFT	96	+7/8 (+0.92%)	2,200
PCLN	94 15/16	-1/16 (-0.07%)	2,100

▼ Volatility Alert: Price has shifted by more than 10.0% from previous close.
as of 3/14/00 8:00:46 PM ET
This page is automatically updated every 180 seconds.

ORDER BOOK | NEWS | CHART | JAVA CHARTS | ANALYSIS | COMPANY PROFILE | SEC FILINGS

Order Book

LU : Enter symbol

Lucent Technologies Inc.

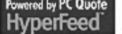
LAST	CHANGE	SESSION HIGH	SESSION LOW	SESSION VOLUME	LAST TRADE
67 3/8	△ +1/8 (+0.19%)	67 3/8	67 3/8	3,000	6:05 PM ET

BUY ORDERS PRICE	BUY ORDERS SHARES	SELL ORDERS PRICE	SELL ORDERS SHARES
67 3/8	500	67 11/16	1,000
67 1/8	2,000	67 7/8	2,000
67	1,000	68 1/8	2,000
66 7/8	2,000	68 3/8	2,000
66 5/8	2,000	68 5/8	2,000
66 3/8	2,000	68 7/8	2,000
		72	7

LAST SALE BASED ON THE CONSOLIDATED TAPE

LAST	CHANGE	HIGH	LOW	VOLUME	52wk HIGH	52wk LOW	PRIMARY EXCHANGE
67 1/4	+13/16 (+1.22%)	68 3/4	66 5/8	3,984,300	84 3/16	48 1/4	NYSE

Market data provided directly from the exchanges via PC Quote HyperFeed.
Data is delayed 20 minutes unless otherwise noted, and is subject to PC Quote, Inc. terms.



as of 3/14/00 8:01:00 PM ET
This page is automatically updated every 180 seconds.

FIGURE 3-7 *MarketXT limit order book*

age investors had little control over and even less knowledge of how their orders were executed during the regular market hours.

Typically, if you wanted to place an order to buy or sell a NYSE stock, you'd first have to contact your broker. Your order would then be transmitted to the brokerage's back office and sent to the SuperDot System. The SuperDot System routes market and limit orders directly to the specialist post for execution. Larger orders would be sent to a floor trader, who would give your order to a specialist on the NYSE. A specialist is an agent that executes stock orders for either the NYSE or AMEX listed stocks. Each stock is assigned one specialist, who, in essence, becomes the expert on that one stock, "making a market" for that particular stock. Making a market means the specialist can post both a bid and an ask on the same security. This is also how market makers increase liquidity on individual stocks. Specialists keep track of all limit and stop orders in their book, remarkably similar to the limit order book used by ECNs.

In addition, because of their unique knowledge of the market, specialists can usually anticipate whether buying or selling interest is building in a stock. With a smaller order, the computer routes it directly to the floor to be executed by the specialist who maintains a limit order book, which contains all the bids and offers for a particular stock.

In the case of Nasdaq stocks, your order would be routed from a stockbroker to a market maker, who is either a representative of your brokerage company or an independent market maker. On the Nasdaq, there are several market makers who trade or make the market in any given stock. The larger the capitalization of a particular stock, the more market makers will make the market in that stock. For example, a stock like Microsoft will typically have 40 to 50 different market makers executing orders. Market makers can be representatives of a specific brokerage firm such as Merrill Lynch, Goldman Sachs, or Morgan Stanley Dean Witter, or an independent market-making firm such as Herzog Heine & Geduld or Knight Trimark.

The larger full-service brokerages claim that you can usually get better prices with them on your order executions. In other words, because your order is being executed directly by a market maker or specialist who works directly with your brokerage firm, the theory is you will likely get a good price on your order fill.

However, the ECNs have successfully challenged this theory by offering faster order fills at competitive prices.

Another option for placing trades was to go through a traditional discount brokerage firm or, with the advent of the Internet, an online broker. However, unlike most of the full-service brokers who had the resources to handle and process thousands of their clients' orders every day, many of the discount brokerage firms were simply too small to be able to do that profitably. Because they could not afford to have their own market makers represented on the stock exchanges or the Nasdaq, they had to find another way to get their clients' trades executed. This need was met by routing orders to an independent market-making firm, which could collect and combine orders from all these smaller brokers and provide order execution on a par with the larger brokerage houses. The smaller brokerage firms benefited significantly by being able to route their orders to these market-making firms, and saved a great deal of money by not hiring their own market makers. This allowed online brokers to pass the savings on to the customer in the form of lower commissions.

You might be wondering what order routing has to do with after-hours trading. First, by fully understanding what happens to your order, you will be in a better position to find the best price for your order. As a knowledgeable investor or trader, you should learn everything you can about the procedures that take place behind the scenes. It is similar to shopping for a car. In the old days, the car dealers had the most knowledge about prices in the form of the famed "blue book." If you bought a new or used car, the odds were so against you, it was nearly impossible for you to get a fair deal. The blue book is similar to the limit order book. In the past, the pros kept the limit order book to themselves. But now, because of ECNs, buy and sell orders are placed on the Internet in the limit order book for everyone to see. When we talk about a transparent stock market, this is what we mean.

PAYMENT FOR ORDER FLOW

Now that you have learned a bit more about order routing, we want to let you know about a widespread but controversial prac-

tice called "payment for order flow" (PFOF). As you know from reading this book, market makers and specialists make their money by profiting from the spread, or pocketing the difference between the bid and ask price. The spread can be as high as 4 or 5 percent on some stocks. Even if a market maker makes an ⅛ of a point on the spread, it equates to $125 for every 1,000 shares. As a result, investors end up paying more for order executions.

Customer orders are so valuable to these brokers that they will actually pay brokerage firms to send orders to them. It has been reported that one major online brokerage receives at least 25 percent of its income from these payments. In the end, the extra costs for this controversial practice are passed on to you in the form of bad order fills.

There are two ways a brokerage firm is compensated for handling a customer's order. The first, obviously, is the broker's commission. The second is PFOF. A small minority of brokerage firms that offer "commission-free" trades are able to do this because of PFOF. Although PFOF benefits both the brokerage firm and the firms executing their orders, the individual investor ends up paying for it in the end.

Critics sarcastically refer to PFOF as a "bribe," where the cost is eventually passed on to the retail investor. Market makers and specialists defend the practice by saying it is a payment for services; after all, they are not working for free. These "rebates" from market makers also allow some smaller deep-discount brokerage firms to charge competitive rates.

Keep in mind that nearly all brokerages engage in this practice, and disclose it on the back of your monthly statement. Generally, the broker is paid approximately 1.5 to 3 cents per share for PFOF ($10 to $30 per 1,000 shares).

The problem: When market makers are guaranteed to execute a trade at a certain price, why should they try to improve the price if they know a competing market maker will get the order? In other words, there is no incentive for market makers to execute the order between the spread when they could get the order at the market price. One way to eliminate this problem is to use limit orders instead of market orders, but there are drawbacks to that as well. Sometimes, the market maker will not execute your order if the limit price you entered is not the current market price. This results in many orders being missed or "run past."

There are signs, however, that this questionable practice might not last for long. In a trend that might continue in the future among brokerages, Datek Online was the first to agree to give its customers a rebate for PFOF. Each month, Datek rebates PFOF fees directly to clients' accounts.

What does PFOF have to do with ECNs? The truth is, one of the reasons that ECNs became so popular was because of PFOF. It was dissatisfaction with the existing system that created an opening for the ECNs and allowed them to flourish. The ECNs basically said they would match any order for pennies without having a middleman play with it first, and without accepting PFOF.

Unfortunately, as mentioned earlier, although PFOF may offer benefits to both the brokerage firms and the firms executing their orders, the individual investor ends up paying the price. Until now, most investors have been unaware that their orders were being sold. But now that word of this practice is spreading, it has started a controversy in the investing world. On one side of the controversy are the brokerage firms. They argue that selling the order flow of their clients to other market makers adds to the overall liquidity of the markets. In turn, this aids all investors that are seeking liquidity with a specific stock. They claim that the practice is totally acceptable and beneficial to the client, even though you will never catch one of these firms discussing the topic.

On the other side of the controversy are people who believe that PFOF is unfair to retail investors. Some of these same people have been instrumental in the creation of the ECNs. When trades are placed on an ECN, each order to buy and sell a stock is exchanged over a computer network and matched without any human interaction. What does this mean to the individual investor? The middleman—the market maker who was making money from the spread on your trade—has been all but eliminated. When you place an order to buy a stock through an ECN, your order goes directly to the ECN to be matched with someone who wants to sell. Now an unbiased electronic system matches your buy order with a sell order. There is little need for human interaction and no potential for human qualities—like greed, for example—to enter into the transaction. In other words, no one plays with your order, and you benefit from cheaper executions.

This is a major reason that ECNs are one of the greatest stock market innovations of recent times. Because of ECNs, millions of investors and traders around the country have been able to profit from their stock trades, in addition to getting much faster order fills. No other innovation has ever put the individual investor on more of a level playing field with the professional Wall Street traders than ECNs.

It is no surprise to us, therefore, that ECN trading is only expected to increase. Although each ECN operates slightly differently, they all do the same basic thing, which is electronically match your orders as efficiently as possible. You might wonder why we need so many ECNs. That's actually a good question. In fact, we can assume that it will be virtually impossible for all 10 ECNs to gain enough market share to survive, and experts predict that there will be many mergers and much consolidation. At the very least, perhaps one day there will be a super-ECN, which would connect all the players together into one seamless network. No one knows who will be left standing as the ECNs battle both among themselves for market share and with the NYSE and the Nasdaq. However, as we said in the previous chapter, you will end up as the winner.

WHAT SHOULD YOU DO NEXT?

Now that you have a better idea of how ECNs work behind the scenes to match orders, we will show you how to open an after-hours account. In the next chapter, we describe which features are most important, explain how your trades are processed, and list the online brokerages that allow after-hours trading.

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4

GETTING STARTED—A GUIDE TO AFTER-HOURS ONLINE BROKERS

There is no doubt that electronic communication networks are revolutionizing the world of investing. There is only one catch: If you're an average, everyday investor, you still need to place your after-hours trades with a broker who subscribes to one or several ECNs. Since it is estimated that more than 5 million people currently use online brokers, chances are you already have a broker and will want to stay with the same firm for after-hours trading.

But guess what? You may not be able to. The rules for after-hours trading vary from those for traditional-hours trading, and your current broker may not yet have the capability to allow you to trade before or after regular market hours. Other brokers may offer after-hours trading, but only if you place a telephone call through a broker and not through an online system. If you're happy with your current broker but can't find after-hours or extended-hours trading on your broker's online site, you'll need to call your broker to find out if it's available. If it isn't, try to find out when it will be, because we're sure it won't be long before it is.

On the other hand, if you are one of the 4 million people who will be looking to get in on the online trading phenomenon this year and you want to trade after hours, we've got good news

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for you. You have lots of choices. Realizing the potential popularity of after-hours trading, a number of brokers have already jumped in on the action. However, the world of after-hours trading offers some new challenges to brokerage firms as well as to individual investors. In this chapter, we'll try to examine several of those challenges and provide you with some pointers for choosing a broker for extended-hours trading.

You would think choosing a broker would be a relatively easy task. After all, there are so many brokers to choose from. But that's exactly what makes the decision such a tough one. There are just too many to choose from. It's impossible for an investor to compare them all. But you do not have to be concerned; there are a lot of people waiting to help you out.

Every day, investors are bombarded by articles, advertising, and hype about brokers. Not a week goes by, for instance, when you don't see at least one magazine or newspaper article comparing or rating brokers. Interestingly enough, these articles never seem to agree on which broker is the best. For example, one publication might pick Schwab as the number one broker; another picks E*Trade. Next month new publications might choose Datek Online, DLJdirect, TD Waterhouse, or any one of a hundred or more broker-dealers. How can this be? If all these supposed financial publications can't pick the best online broker, how in the world can the everyday investor do it?

Compounding the confusion, online brokers are engaged in an all-out advertising war. Just leaf through any financial magazine these days or watch TV for just an hour and you'll see what we mean. One issue of *Money* magazine, for example, ran no fewer than seven different full-page ads for various online brokers, some of them including application forms and postage-paid reply envelopes. Every broker also offered a sign-up incentive of some kind to new subscribers in the form of either money, free trades, or other free benefits. The competition is fierce.

In fact, advertising has been so effective at increasing online customers that brokers are planning to spend even more money on it. A Lehman Brothers report estimates that the eight largest online brokers will spend approximately $1.2 billion on their combined advertising budgets in 2000. The report goes on to suggest that the amount to be spent by these major brokers, including Schwab,

E*Trade, and Ameritrade, to attract new customers will surpass even the combined spending of Burger King and McDonald's, and will exceed the advertising budgets of Walt Disney and Coca-Cola. They are spending an awful lot of money to win your business.

And obviously, the advertising is working. Online brokers are adding new investors by the thousands every day. It is no wonder that with so many brokers to compare, people in search of a broker simply end up choosing the one that advertises the most or simply advertises the cheapest commissions. But these are not necessarily the best reasons to choose a broker for after-hours trading, and we'll show you why.

MONEY ISN'T EVERYTHING

Commission charges should never be the only reason for choosing an online broker, especially for after-hours trading. If you trade a lot or don't have much money to invest, we can understand why you might be tempted to go with the lowest possible commissions. But keep this in mind: People who choose a broker based upon the advertised price for regular market trades might be disturbed to learn that the cost can go up for after-hours trades. Why? Because all trades must go to the ECNs during the extended-hours trading sessions as limit orders. When you instruct your broker to buy shares for you at or below a certain price, or sell shares at or above a certain price, you've entered a limit order. Limit orders reduce the risk that an order will be filled at a price you don't like. The opposite of a limit order is a market order, in which the broker is instructed to execute the trade at the current price.

A firm may charge a commission for market orders, which is usually the advertised rate, but often charge higher commissions for limit orders. Why are limit orders more expensive? According to the brokers, it's because limit orders represent more work. Remember that a limit order tells a broker that you want to buy a certain stock for a set price or better, and so there is a chance that a limit order will not execute immediately. Since the order may remain open a long time, the firm has to keep track of the open

limit orders and then contact the customer later to report that the order was executed.

But that's not really as big a problem during after-hours trading. Since trades are processed on an ECN without human intervention, in our opinion, the argument that limit orders cause more work doesn't make sense. If there is no match on an ECN, your order is killed at the end of the after-hours trading session. That being the case, we don't think brokers should charge more for limit orders during after-hours trading, although many of them do. We, therefore, recommend that you choose a broker that charges the same commissions for both market and limit orders.

In addition, brokers vary regarding the number of shares you can trade at the advertised amount. You must check with your broker on his or her commission schedule. Some brokers charge a per-share fee with a minimum, while others have a fixed fee up to so many thousand shares. As you can see, there are differences in the commission structures. In addition, sometimes the advertised low commission is not the price you'll end up paying. So when you shop for your broker, do not necessarily pick the one with the lowest advertised price. Break down your commission costs for the way you trade. Some brokers are more expensive if you are trading penny stocks (stocks under $5) or options or less expensive if you are trading large share sizes. You will not know for sure until you do the calculations yourself.

Certainly, if you'll be making a large number of trades or trade in large lot sizes, commissions can make a significant difference to your bottom line. For those who trade frequently, some firms offer reduced commissions. In fact, Schwab announced reduced commissions for online investors who make at least 30 to 60 trades per quarter. E*Trade also offers special reductions for frequent traders. Several other brokers offer frequent-trader rates, too, so be sure to ask how you qualify for them. The bad news? A broker may not honor frequent-trader discounts in after-hours trading sessions, so be sure to check it out before you make your final broker selection.

Consider this, too: If you have $100,000 or more to invest, commissions may not be a factor at all. Some online brokers have been known to treat higher-net-worth individuals more preferentially than individual investors just starting to build their portfo-

lios. Although commissions might be slightly higher with some of these firms, in the long run, you could actually make out better if you qualify for one of their special programs. In fact, some brokers may provide free trades depending on your assets, so think about that before you sign up for a broker who might not appreciate your business.

Another issue to keep in mind is how much a broker charges for placing trades by telephone, through either a touch-tone service or a live broker—if telephone trades are allowed at all for after-hours trading. Some brokers do not permit you to place trades by telephone during after-hours trading, so you can only place them online. This could be a problem if you travel a lot or you're not near a computer or wireless device, but want to place a trade after hours. Commissions are generally higher for telephone-based trades, but many brokers will honor the online rate if there's a problem with the web site and you can't get logged on to make a trade. Be sure to describe the problem and specifically ask for the online rate. Most will oblige even if it's not a networkwide problem.

Be sure to also look at a broker's hidden charges. Some brokers charge you extra for a variety of transactions, such as postage and handling fees for mailing confirmations or stock certificates. Sure, they may advertise low commission rates, but then they nickel and dime you to death with miscellaneous charges. These hidden costs bring your trading costs up in the long run, too. You may have to pay for wire fees, check-writing privileges, ATM debit cards, account inactivity fees, odd-lot fees, and frequent-change-order fees. Remember to evaluate the overall cost of an account.

The bottom line is that you need to be very aware of not only a broker's commission structure, but also the miscellaneous fee schedules. Unfortunately, this information is not necessarily the easiest to find on a broker's web site. Nor is it always the easiest to understand, especially if a broker offers many different products and programs. For those of you who would like to have someone else do the legwork for you, you might want to look at some of the annual broker surveys conducted by *Barron's, Smart Money, Money, Individual Investor, Your Money, Kiplinger's, Worth,* and *Active Trader.*

In addition to listing the best overall brokers in a number of different categories, one web site contains a handy chart that compares the limit order commissions for different brokers based upon the number of shares purchased, from 100 to 10,000 shares. This report on brokers can be found at www.sonic.net/donaldj.

Another extremely useful site for finding information about brokers is Gomez Advisors at www.gomez.com. This is a popular compilation of helpful data about various online brokers, with ratings, comparisons, and reviews by other users and experts.

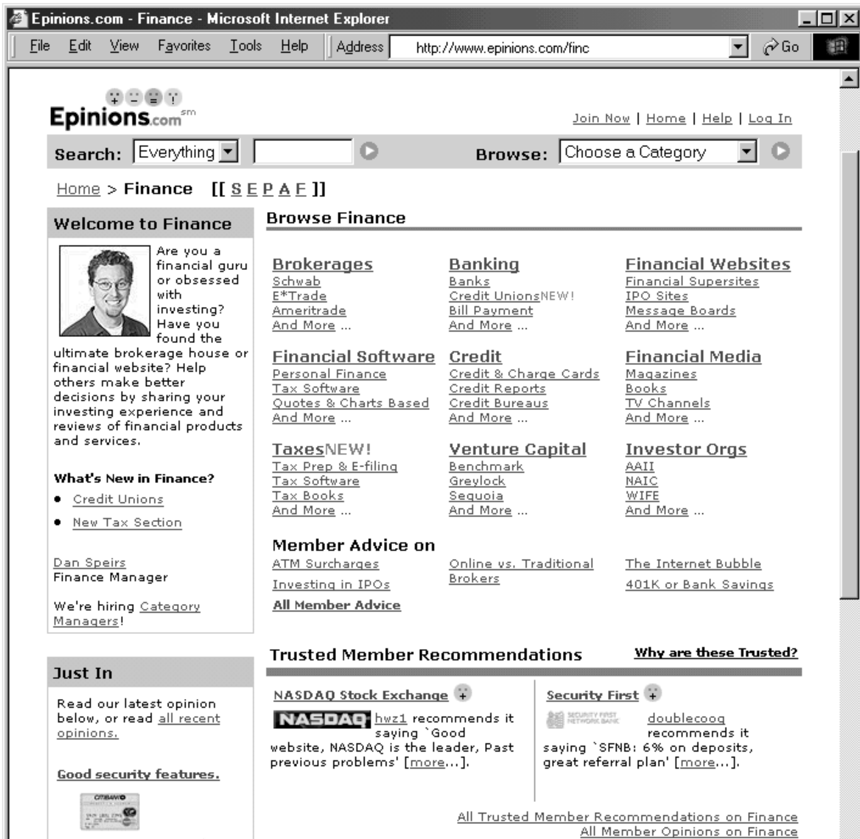
We also like the web site www.epinions.com (see Figure 4-1) because it contains reviews of brokers written by everyday, average users, who tell you about their experiences. Epinions pays a minimal fee for writing a review and an additional fee each time the review is read. Reviewers try to balance the good features with the bad, so you can get a better overall picture of a broker's services. For this reason, we find these reviews a step above some of the chat rooms where people just seem to want to vent their frustrations.

WHAT KIND OF AN INVESTOR ARE YOU?

While we will readily admit that commissions might be an important factor to people who are planning to make a large number of trades or have only a small amount of money to invest, we think there are a number of equally important issues to consider before choosing a broker. For example, how reliable is the online broker's web site? What good does it do you if your broker has inexpensive commissions but you can't get through because the system is down? Other questions to ask brokers might include how fast do they execute trades? Do they provide you with adequate customer service at times when you will most likely be doing your online trading? Is their web site hassle-free and easy to navigate? Depending on your overall trading objectives, these may all be important issues for you to consider.

That's why, before you choose an online broker, we believe it's important to determine what your financial goals are and what your needs are. Not every online broker offers the same ser-

FIGURE 4-1 *Epinions.com web page*



vices, so you need to know what it is you are trying to accomplish before you can find one that meets your needs. At the very least, ask yourself these basic questions: What are your trading objectives? Do you want to buy stocks and hold them for long periods of time, or are you more interested in trying to make shorter-term trades? How much money do you have to invest, and what kinds of products do you want to buy?

Let's say, for example, you are interested in trading stocks, mutual funds, and bonds for long-term growth. The speed of an online broker's trade execution would probably not be an impor-

tant consideration for you. You simply want to be able to buy a few shares online and stash them away in your portfolio to watch them grow. In this case, it might be more important to find a broker that offers you a wide array of investment choices, provides lots of research tools, and has a reputation for long-term stability. A little-known broker with a limited number of mutual funds and no bonds to choose from wouldn't help you meet your stated financial objectives. If you want to trade on a short-term basis, on the other hand, the speed and reliability of a broker's online system will matter a great deal.

It has been our experience that people go through different phases of development when they decide to become active investors. There are different tiers of investors, each with a different level of sophistication and knowledge. At the beginning of your development phase, at the lowest tier, you might feel more comfortable using a large, reputable broker with a real, live person—someone who can give you stock suggestions and help you manage your money as you start to build your portfolio. As you become more experienced and knowledgeable about investing, your investing style and objectives will change. Over time, you will need or simply want different things from your broker at different phases of your development. Today, you might not feel bad about paying a broker $150 for a trade. But once you are more experienced and know what you want to buy, you may feel a lot better paying only $10 for that same trade.

Of course, there will always be people who are not interested in making decisions for themselves, especially if they feel they're not knowledgeable enough. If you're one of these people, you might be more comfortable steering clear of online brokers and choosing a more traditional full-service firm. You'll be assigned your own personal broker who can provide you with investment suggestions. But keep in mind that these personal brokers are paid on commission. Since they only make money when you place a trade, it's in their best interest for you to trade as often as possible. For the investor, heavy trading results in more commissions and also short-term capital gains, which can reduce overall investment returns.

Moreover, going through a traditional broker means you'll generally pay more in commissions than you will with an online

service. What happens when you find a company you want to invest in, but only have enough money to buy a few shares each month? Naturally, you'll pay a commission cost for each monthly transaction, but sometimes the commission costs will equal or exceed the cost of the stock. Doesn't sound like a win-win situation, does it?

We have one suggestion for you that might help: Choose a brokerage firm that also offers you an online component. In this way, you get the best of both worlds: You can get help from a broker when you need it, and you can place your own trades if the situation calls for it. When you're ready to trade online, at least you will already have an account set up, and all you'll need to do is enable an online trading account and pick a password.

HOW YOUR TRADES ARE PROCESSED

It's 7:00 p.m. on a Wednesday evening. You're hunched in front of your computer, focused on the limit order book blinking on the screen in the middle of your home office. You watch the bid and ask figures appear on the screen, and you notice that there are 200 shares of Microsoft offered at $40. Finally, a chance to own Microsoft at a price you can afford. (By the way, if you haven't figured it out yet, you're dreaming!) You go to your firm's trading screen, enter your limit order, and press the Enter key. The trade is executed, and you are now the proud owner of 200 shares of Microsoft. Well, not quite. Those 200 shares are long gone, and your order never even appeared in the limit order book.

Unfortunately, the above scenario isn't far off from what happened to a number of online investors in 1999, as well as in 2000. There were a significant number of reports of trades not being executed or being executed too slowly. Perhaps you're not sure why this might happen, so we'll try to explain.

When you sit in front of a computer screen and place a trade, it is easy to believe that you are linked directly to the market. After all, when you press the Send key, it feels like your trade is being placed instantaneously, doesn't it? Contrary to what most online brokers would like you to believe, you are almost

never connected directly to the market in any way. Only a registered representative or broker can place a trade for you—at least at this time. But an online broker can't fill your trade order directly, either. All the broker can do is route your order to the marketplace, or in the case of after-hours trading, to an ECN.

When you place an order using your personal computer, it travels over some pretty complicated telecommunications networks to your Internet service provider, which routes it to your online broker's computer system, then to the broker's back office and clearing firm, and ultimately to the appropriate destination for execution. Once an order is filled, the execution information must make its way along the same path back to you. Keep in mind that all these steps happen relatively quickly and seamlessly without human intervention—most of the time.

However, because the underlying online infrastructure is composed of complicated computer hardware and software, no system can ever be infallible. The best you can hope for is an online service that is fairly reliable. Like everything else in the business world, some firms have higher levels of technical expertise than others. There are bound to be differences in system reliability and also differences in how well or how quickly each system processes its trades. Individual investors need to realize the number of layers of complex functions behind the computer screen. Depending on a broker's technical capabilities and the stability of its technology, a system that might work adequately in normal trading conditions may slow down or bottleneck during peak times. There may also be times when the entire system shuts down or slows to a proverbial snail's pace. Investors could find themselves waiting long periods of time for an execution, or even worse, missing out on a trade altogether.

In 1999, for instance, there were so many complaints about missed trades or slow processing that regulatory bodies made brokers post a disclaimer to educate and alert investors to possible delays. Online brokers are now required to balance any advertising of "speed" or "fast executions" with a disclaimer that system availability and response time may be subject to market conditions. If you look closely at the small print at the bottom of an online broker's trading pages, you should now see this disclaimer.

Ironically, when you complete an application to open an account with an online broker, you will be asked to sign a customer agreement. In this agreement, you'll usually see the broker's disclaimer for a variety of problems, including those created because of software and hardware inadequacies. Signing an agreement like this, where a broker can presumably do anything and not be blamed for it, can be a little disconcerting. So before choosing a broker, it's up to you to try to determine the broker's reliability.

Since it's impossible for you to use and test all the online services, use the sites previously mentioned like Gomez Advisors. Gomez has conducted reliability tests on many of the online brokers, so the ratings are invaluable. And word of mouth can give you current feedback about a broker you're considering, too, so be sure to check out all the available information for a wide variety of opinions. If the majority of opinions about a particular broker are negative, you can generally conclude that there may be some problems with reliability.

In addition, we recommend that you find out about your options for placing a trade if you are unable to access your account online. Most brokers offer alternatives, such as touch-tone telephone trades, faxes, or the low-tech way—talking to a broker over the phone. Remember, make sure you know whether using these alternative forms of trading will increase your costs. One other caveat: If you experience online delays, there is no guarantee that you won't experience delays when you turn to one of these other alternatives. A live broker often will have to enter your trade into the same system that's not working for you, but at least having other options might make the whole process a little less frustrating.

CUSTOMER SERVICE

If you log onto some of the sites we mentioned previously, like Gomez or Epinions, you might be surprised to learn that one of the most often repeated complaints about online brokers is poor customer service. Some people have horror stories of long waits

on hold or unhelpful service representatives. In light of the tremendous advertising budgets and the influx of new investors to online providers, perhaps the lack of customer service at some brokerages is understandable: Can the firms adequately service all these new customers? Again, some brokers will be able to; others will prove that they can't.

Only you can decide how important good customer service is to you. While most online brokers won't give you investment advice, you should demand at least a minimal level of service and assistance with technical system problems. You can read through all the broker reviews and online complaints and get a good feel for which brokers are not providing adequate levels of customer service. For more objective input, take a look at a study performed by J. D. Power and Associates at www.jdpa.com. The Online Trading Customer Satisfaction Study (first annual study released in August 1999) measured customer satisfaction with web brokers based on a nationwide survey of 2,740 online investors. Six factors were evaluated, including customer service, information/education, integrity/reputation, processing, portfolio management, and fees/commissions.

According to the study, customer service was the most important among the six factors measured. Although many of the brokers have customer service representatives available 24 hours a day, 7 days a week, others do not. Does the 24×7 availability make a difference? Maybe. It depends on your trading habits and when you want to be online. It has been our experience that some service departments have been closed on holidays, weekends, or days that the stock market is closed, which can be frustrating to people who work and want to be online exactly at these times. That's why you need to make sure that customer service hours are available whenever you need them, and that you can obtain at least an adequate level of expertise from the service representatives. We recommend that you choose a broker that is available to help you 24 hours a day, 7 days a week, whether you are trading or not. The good news is that most brokers are moving to the 24×7 model to accommodate the large volume of traders entering the market.

With all the advertising currently going on, it will be interesting to see what the Online Trading Customer Satisfaction Study

results will be in 2000. Interestingly, according to the study, the biggest stumbling block for online investment providers is resolving major problems with customers' online service. Of the 11 percent of respondents who reported a serious problem with their online service, nearly 60 percent said they were extremely or very dissatisfied with the resolution of the problem.

A PASSION FOR SPEED

Another feature to consider when selecting a broker for after-hours trading is the speed of execution. In other words, how fast does the broker execute the trade once you press that button? According to experts, the true cost of investing is not commissions, but execution quality and speed. Why is speed important? We think it's for one simple reason: The early bird gets the worm.

In the case of after-hours trading, when you send an order to an ECN, your order is prioritized on a first-come, first-served basis. That is, if you are the first order in the limit order book and there is a match, your order is the one that gets filled. But if your order is not matched, it takes its place in the limit order book in the order in which it arrives. If you cancel or change your order in any way, you lose your place in line, so to speak, and have to start over again. If your broker can get your orders to the ECN faster, it stands to reason that you can better your chances to make a match.

Unfortunately, there are no SEC regulations that require a trade to be executed or confirmed within a set period of time, and it's difficult to measure speed in a quantifiable sense. At the current time, Datek is the only broker we know of to have a time-limit guarantee on its order execution: If your marketable order is not executed within 60 seconds, it's commission free. (The key word here is "marketable.") If firms advertise their speed, remember that they must not exaggerate or fail to tell you about the possibility of significant delays. Be sure the broker at least has a disclaimer to that effect.

We can point you to a site that provides some quantitative data on several brokers. It's called Keynote (www.keynote.com).

This site tracks how well or fast a potential broker may execute your transactions during regular trading hours.

Keynote Systems, Inc., claims to be the world's leading supplier of Internet performance measurement, diagnostic, and consulting services to companies that are involved in e-commerce. According to its site, the Keynote Web Broker Trading Index tracks the average response time in seconds.

To perform the standard Keynote broker transaction test, Keynote enters a web site through the broker's home page and logs into the trading area. Then, Keynote obtains a stock quote, creates an order to buy stock, and logs out before confirming the order. Each transaction is created through a standard trading account set up by Keynote. Transaction success rates are the ratio of successful transactions to attempted transactions, and statistics are updated weekly.

By accessing Keynote's site, you can obtain up-to-date information about the performance of certain selected brokers. This site is helpful if you're considering a broker that is measured, but currently only about 20 web brokers are included. You will notice that not all the sites are measurable, so remember to check out the site periodically for updates.

Worrying about fast executions, however, is not your only concern. In addition to fast order execution, you need to determine how fast a broker confirms your orders. Many firms do not update customer account information to reflect the day's transactions until hours after they're finalized. And some online brokers can be so slow to deliver confirmations that investors can't tell for hours whether or not a trade was executed.

Due to slow or outdated information, investors have mistakenly assumed that their orders were not executed and placed duplicate orders in the regular or after-hours market. They end up either with twice as much stock as they could afford or wanted or with sell orders for stock that they do not own. Canceling or changing an order can also be difficult when you don't have accurate and timely information about your trade execution. Many brokers require you to call them to confirm that orders have been canceled. Quite often an order may still be "live" or executed without a report. So when in doubt, call and ask for a verbal confirmation of your online order.

Naturally, in an effort to protect themselves from irate investors who post duplicate orders due to slow confirmations, brokers have added another disclaimer. This disclaimer basically says that customers participating in extended-hours trading will be responsible for ensuring that executions received as a result of extended-hours trading are not duplicated by traditional-hours trading activity.

Obviously, by posting such disclaimers on their web sites, some brokers feel they have absolved themselves from liability if you duplicate your orders. Before you sign up with any broker, therefore, it is important to determine the firm's policy on order confirmations and how they are handled. Several brokers offer the ability to monitor your order when it is executed. Others provide online alerts or automatically update your account balances and portfolio when a transaction goes through. To protect yourself, we recommend that you look for a broker that has advanced confirmation systems like these already in place.

LIMIT ORDERS AND LIQUIDITY

In addition to the possibility of delays due to market conditions, physical system limitations, and slow order executions and confirmations, an investor should also realize that limit orders to buy or sell could also delay trades. Remember, only limit orders are allowed during extended-hours trading. When you place a limit order to buy, you agree to pay up to a certain amount for a stock. If there are no matches on the ECN during the extended-hours sessions, that is, if no one wants to sell at or better than your price, you will have to wait until a match occurs. There is also a good chance that your trade may not be executed at all if no matches are found.

To improve your odds of being matched, an ECN strives to attract a significant number of orders. In the after-hours game, this is called liquidity. The greater the volume of orders on any ECN, the greater the liquidity. If you've watched CNBC lately, no doubt you've seen mention of Instinet and Island during the after-hours trading sessions. Instinet has been around a long time

and has more than sufficient liquidity. In addition, Island ECN is one of the biggest ECNs, and its after-hours trading program is one of the most established.

Why is liquidity important in choosing a broker? If you choose an online broker that routes its orders through an ECN that has greater liquidity than other ECNs, you will have an easier time finding a match. Right now, of course, the largest ECNs will have the best liquidity. However, in the future, there will probably be a consolidated system, where each ECN will talk to all the other ECNs to find the best price available. This can improve your chances of having your order matched, and in essence, increase liquidity. Until this consolidated network emerges, however, it is to your advantage to choose either a broker that works with an ECN that has sufficient liquidity or a broker that routes its orders through several ECNs to improve liquidity.

THE IMPORTANCE OF THE ECN

If you're a long-term investor who is just interested in making an occasional trade, does it really matter which ECN your orders are routed to? Outside of the liquidity issue, perhaps not. But if you are a new investor with not a lot of money to invest, you may be limited to certain ones. For example, let's say one ECN will only accept a minimum order of 100 shares during the after-hours session and will require that additional shares be bought in 100-share increments. Depending on which stocks you want to buy, you may not be able to afford to buy that much. But if you trade through another ECN, you may only be required to trade a minimum of 25 shares and buy additional shares in 25-share increments. That may be more feasible for your budget. If that's the case, you would want to determine the after-hours purchase minimums and choose the ECN and broker accordingly.

In the not too distant past, when you wanted to trade in the premarket hours, only a couple of ECNs were open. The same situation would have existed if you had wanted to trade between 8:00 and 10:00 p.m.—only a few ECNS allowed trading that late in the day. So if you want to trade in premarket and late-evening

hours and only a few ECNs allow you to trade until 10:00 p.m., you need to find a broker that routes orders to those particular ECNs. We predict, however, that by the time you read this book, the demand for after-hours trading will have become so great that the operational hours of most ECNs will already have been expanded, meaning you'll be able to trade at virtually any time no matter which broker you choose.

Although Island and Instinet are the most liquid ECNs right now, the other ECNs all have plans to challenge that liquidity. The stock market as we know it is reinventing itself and changing, thanks to the massive threat of competition. Who can predict what the fallout will be?

All we can do is arm you for this battle in the best way possible—with knowledge. We hope we've provided you with an overview of some of the issues to consider before choosing an extended-hours broker and resources to consult when you need help. The important thing to remember is that any broker you choose for after-hours trading should work with an ECN that allows you to meet your trading needs—whatever they are. Remember, too, that you need to find a broker that allows you to take full advantage of after-hours trading. Determine what it is you need, want, and expect from a broker and find one that best fits those needs.

Keep in mind that there's no rule about how many brokerage accounts you can open. Depending on how much you have to invest, consider opening an account with more than one broker. Then see which one provides you with the most reliable service or which one feels the most comfortable to you. While you might have a little more bookkeeping due to multiple accounts, in the long run it might be worth the effort.

OPENING AN ACCOUNT

Now that you're aware of the issues to consider, you are ready to think about opening an account with an online broker. At the end of this chapter you'll find a listing of a number of online brokers that currently offer extended-hours trading. Before making

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any decisions about which one to sign up with, we recommend that you preview a few of the sites to see if you like the way they look and if they are easy to navigate (just enter the www address listed). While you might not be able to get into the actual trading section of the site, there are many features you can try out without completing an application or sending in money. Many of the sites offer demonstrations or tours, so check those out, too.

You may also be interested in playing some of the trading games available before you risk your own hard-earned money on real trades. Simulated trading games can give you a feel for what it's like to trade without putting your own money in jeopardy. These games are cheap, good practice, and fun.

Many simulated trading games have become quite sophisticated. They offer real-time quotes and portfolio tracking. Some have order entry screens that at first glance may look like those of an actual broker. In the winners list you will see individuals with 1,000 percent returns over 3-month periods. Be wary of these results, because in the end it is only play money. As the competition becomes more intense on these simulations, participants often pick extremely speculative positions. You won't be able to win this contest with GE or IBM. Just remember these simulations are for enjoyment but have very little correlation with actual trading results.

One popular investment game that offers real money can be found on Yahoo!'s web site at http://finance.yahoo.com. E*Trade also offers an investment game, which can be found at E*Trade's web site, www.etrade.com.

If you're anxious to get started, however, and are ready to take the plunge into the world of online trading, have no fear: Brokers have made the enrollment process as easy as possible. Simply go to the home page of the web broker site of your choice and locate the button that reads "Open a new account" or something similar. Every broker we examined allows you to apply online. Some allow you to input your information on screen, print the completed application, sign it, and send it in with your opening deposit. Others have application forms available for download using Adobe Acrobat, which allows you to print the forms and fill them out.

If you don't have Adobe Acrobat, many of the sites will provide a download link for you, which will load it onto your com-

puter automatically for free. For those of you who would rather talk to a live person, you can enroll by telephone, or you can visit a local office if the broker offers that convenience. Brokers that have branch offices usually equip their sites with a branch locator for your convenience. Just enter your zip code and you'll see addresses and telephone numbers of the branch offices nearest you.

The first question you'll be asked on these applications is how you would like to register your account. Typically you can choose from the following list: individual, joint, retirement, or custodial. An individual account would be just for you. A joint account would include you and another person.

Several types of retirement accounts are available, such as traditional, rollover, and Roth IRA. Each has its specific tax consequences, so you should consult a tax adviser or financial planner. A custodial account is for a minor (a child under the age of 18). Other account types might be available, depending on the brokerage.

Many brokers will also allow you to open and trade through retirement accounts, in addition to business retirement plans and education IRAs. Trading within a tax-deferred account like an IRA or other retirement plan can provide you with certain tax advantages, and any gains remain tax-deferred in your account until you withdraw the money. One disadvantage, however, is the fact that an IRA account can only be a cash account. If you plan on short selling or using margin, you won't be able to do so within an IRA account. Again, the type of account you open should be based on your financial goals and objectives.

The second question you will be asked is what type of account you would like to open. You can generally choose from regular cash investment accounts or margin accounts, but remember, some brokers may not allow you to short-sell or use margin during after-hours trading. When you buy stock on margin, you are borrowing money from the broker. As the stock price or margin requirement changes, you may be required to increase your margin deposit. In volatile markets, investors who have put up an initial margin deposit for a stock may find themselves being required to provide additional cash if the price of the stock subsequently falls. As you might expect, borrowing can be very risky if you're a beginning investor, so we discourage it in after-hours trading for all but the most experienced, disciplined in-

vestors. If you think you're one of those experienced traders, take a look at our advanced after-hours strategies in Chapter 9 for more information on selling short in the after-hours markets.

Be aware, too, that individual brokers differ with regard to how much they charge for retirement accounts. A few offer free IRAs, with no annual maintenance fees and no surrender charges if you want to withdraw money. These are important items to check out before deciding what type of account you want to open.

After you've selected the type of account you want to open, you may be asked a variety of personal questions about your financial status. These questions vary from broker to broker, but they might include whether or not you're employed or retired, how much your annual income is, how much investing experience you have, and other similar questions. Be prepared to answer these questions, as you may not be able to continue completing the application if you don't fill in the blanks as requested. You may run into another obstacle if you or a member of your household is a director or 10 percent shareholder of a publicly traded company or is currently affiliated with or employed by a member of a securities exchange or the NASD, bank, trust, or insurance company.

Once you've passed these hurdles and completed the application, you will need to send it in with a check for at least the minimum deposit, which varies by broker. For your convenience, we've included the minimum deposits in the broker listing at the end of this chapter. Most range from $1,000 to $5,000, but some will be higher or lower, depending on the type of account and the services provided. In addition to paying by check, most brokers will permit you to make a direct transfer of funds from your bank or will let you transfer assets or securities from other institutions. Be sure to read the web site application instructions for a list of your options for funding your account.

Sending a check to an online brokerage can be a little scarier than walking into a brokerage house and handing your cash to a live person. For this reason, the first thing to do is make sure the firm is reputable. If it's one of the brokers listed at the end of this chapter, you can be virtually certain that you won't have to worry about this step. You can also check out brokers on www.gomez.com or try the NASD Regulation Public Disclosure

Program site (http://www.nasdr.com/2000.htm). Be sure to mail your application and check to the correct address, though. The web site should list the mailing address clearly, but if it doesn't, be sure to call and verify it. If the broker you've selected has a local branch office, you can also probably drop your application and your deposit off in person.

While checks are usually deposited within 24 hours of receipt, don't think you'll be able to trade right away. Although a few brokers allow you to apply without sending in any money at all, most of them require your deposit before you can make a trade. As a rule, including mail time, figure that the application process might take at least a week. Minimally, it takes 3 to 4 days after all your application materials are received, and many brokers will wait for your check to clear before they apply the money toward your account. If you are transferring assets or securities from another institution, this will also prolong the process. Eventually, however, when the application process is completed, you will be notified with your account information and allowed to set up your passwords to get into the trading section of the broker's online site.

Although some people don't like to enter their password more than once, we think you should favor brokerages that use several layers of password protection. For example, using one password to access your account and another to place a trade does not seem all that cumbersome in light of the extra security it can provide. You might also check out the encryption technology that a broker uses to safeguard transactions, preferably 128 bit. Be aware, however, that your current web browser may need to be updated to work with this higher-level security.

While the interface for placing after-hours trades may look much the same as it does during regular trading hours, you may be directed to a separate after-hours section of the broker's web site and be required to enable your account for after-hours trading. Because of the unique risks involved, when you log into this section for the first time, you will be requested to read and agree to a disclosure statement, which basically signals that you understand what you're getting into. Don't be afraid. Just take some time to become familiar with the screens and their functions and do your research—just as you should with any other stock purchase. Good luck, and we wish you good trading.

BROKERS WHO OFFER EXTENDED-HOURS TRADING

The following list is by no means all-inclusive. After all, there are more than 100 brokers and to list them all would require another book. We have tried to include at least some of the largest brokers, so people who already have accounts would be able to see if their firms offer after-hours trading. Please realize, however, that every day more and more brokers add after-hours trading capabilities to their list of services. And while we have tried to be accurate as of the time of this writing, even those brokers who currently offer after-hours trading are changing their requirements as quickly as the ECNs are changing.

If your broker is not listed here, be sure to call your broker to find out if you can trade after hours. Ask, too, how your trades are routed and with which ECNs your broker is affiliated. We are pretty sure the telephone representatives or your stockbroker will be able to answer your questions. If not, you can always think about taking your business elsewhere, especially if your heart is set on after-hours trading.

If you already have an account with one of the brokers listed below, it will take very little effort to enable your account for after-hours trading.

Datek Online (www.datek.com)   ECN: Island ECN
1-800-U2-Datek
Commission: $9.99 per trade.

Datek Online requires no minimum initial deposit to open an account (see Figure 4-2). After-hours trades can be entered online for $9.99 or by telephone for a slightly higher commission. If you already have a Datek account, you will need to first enable your account for extended-hours trading. Be aware, too, that the streaming portfolio called "Streamer" will not display extended-hours prices, but it will display the Nasdaq closing price. However, your online account balance will immediately reflect after-hours price movement. You can get into the extended-hours section of Datek's site very simply from its home page, and the information you'll find there is clear and more complete than at many other

FIGURE 4-2 *Datek Online web page*

sites. Customer support is available 24 hours a day, 7 days a week, via e-mail or telephone. There is no minimum number of shares per order, and the maximum number of shares per order is 5,000.

Morgan Stanley Dean Witter Online (www.msdwonline.com)
ECN: MarketXT
1-800-58INVEST (1-800-584-6837)
Commission: $29.95 for limit orders up to 1,000 shares. If more than 1,000 shares, then 3 cents per share on the entire order.

The minimum account deposit for Morgan Stanley Dean Witter Online is $2,000. Extended-hours trades must be placed on the

Internet only; no telephone orders are accepted. You can view the extended-hours trading information section of this web site without opening an account. From the home page, simply click "What We Offer"; then click on the words "Extended Hours Trading." You will find an explanation of how after-hours trading works, along with a demo, which displays the symbols of all securities available to trade in any particular session. Customer service support is available 24 hours a day, 7 days a week, by telephone and e-mail. The maximum order is 10,000 shares.

TD Waterhouse (www.tdwaterhouse.com) ECN: REDIBook
1-800-934-4448
Commission: $12 for market and limit orders up to 5,000 shares; for over 5,000, there is an additional charge of 1 cent per share for the entire order.

The minimum deposit to open an account is $1,000. Trades must be placed on the Internet through the Extended Hours Trading Center only; orders may not be placed by telephone or through a branch office. When you go to the TD Waterhouse web site, you may be a little confused because there is no immediate mention of after-hours or extended-hours trading on the home page. To see the extended-hours trading section, you must already have an account. If you already have an account with Waterhouse, once you are logged in, you can get to the Extended Hours Trading Center by clicking on the trading tab and then choosing the extended-hours tab (as opposed to the traditional trading tab). If you click on the log-in marker, you'll be taken to the log-in screen, where you can view the webBroker demo.

Customer service support for the electronic brokerage is available 24 hours a day by telephone and e-mail, and TD Waterhouse has 170 branch offices nationwide if you prefer face-to-face assistance. Check out the branch locator to locate the office nearest you.

Charles Schwab (www.schwab.com) ECN: REDIBook
1-800-435-4000.
Commission: $29.95 for limit orders up to 1,000 shares; 3 cents per share over 1,000.

Trades can be entered during the after-hours session either online or by telephone. However, at this time, after-hours trades cannot be placed through Schwab Tele-Broker, or through automated telephone services, or in the branch offices. Schwab requires a fairly large minimum deposit of $5,000 to open its standard brokerage account (the Schwab Account). Customer service is available online via e-mail anytime, and it is available from live representatives 24 hours a day and during regular business hours in more than 350 branch offices.

Once you locate the after-hours section on Schwab's web site, you will notice that Schwab offers one of the most comprehensive after-hours sites available, although it was a little hard to find. To get there from the home page, click on the investments tab and then on the stocks and options tab. If you click on the after-hours button, you will see a detailed description of how after-hours trading works—in general and on Schwab—with a helpful glossary of terms, as well as questions and answers that are clearly written and very informative. Also included is a nifty comparison chart that shows how trading during standard market hours differs from after-hours trading at Schwab. The minimum after-hours order is 100 shares, and the maximum order is 5,000 shares. All orders must be entered in round lots (in increments of 100 shares).

DLJdirect (www.dljdirect.com) ECN: REDIBook

1-800-825-5723

Commission: $20 for limit orders up to 1,000 shares, plus 2 cents per share thereafter. (Select clients with at least $1 million in assets with DLJdirect can trade for $20 a share up to 5,000 shares, plus 2 cents thereafter.) *Note:* DLJ charges the same commissions whether you access your account through the web site, a touch-tone phone, or a live representative.

DLJdirect does not require a minimum deposit to open an account. The company has made the application process so easy that you can place your trade in virtually minutes. To open an individual, joint, or custodial brokerage account, all you have to do is complete the application online and submit it to DLJdirect. It will review your application immediately and check your

financial background with a credit-reporting agency. If you are approved, you can generally begin trading that same day, but you're limited to $15,000. After you place a trade, however, you have to deposit sufficient funds to cover the trade within 3 business days. What if your application requires further attention? The company promises to contact you within 1 business day.

You can place trades during extended-hours trading sessions on the web site, Marketspeed, and telephone via an investor services representative only. AOL, Tradetalk, and wireless platforms are not yet available. DLJdirect's web site does an excellent job of explaining how this online broker handles extended-hours trading and provides a list of the stocks that are unavailable during extended hours. To preview its site, click on "Extended Hours Now Available" under "What's New" on the home page. Customer service is available 24 hours a day, 7 days a week. The minimum order size is 100 shares, and subsequent shares must be in increments of 100 shares. There is no maximum order size.

E*Trade (www.etrade.com) ECN: Instinet

1-800-STOCKS-5.

Commission: $19.95 per trade on limit orders up to 5,000 shares; 1 cent per share over 5,000; $15 more for after-hours trades placed with a broker.

E*Trade allows you to make trades during the after-hours trading session through its online web site and by calling live brokers. If you want to try out a broker's site before making a trade, E*Trade allows you to become a "member" without having to commit any money. As a member, you get access to many features, but if you want to trade, you'll have to open an account and become a "customer." You can open an account with a minimum deposit of $1,000. The minimum is $2,000 if you want to open a margin account. For those who are already E*Trade customers, all you have to do to trade after hours is read and accept the after-hours disclosure. Be aware, however, that some of your E*Trade features will not be available during the extended trading hours. For example, you won't be able to get "smart alerts," an automated alert system for E*Trade customers—at least at this time. Extended-hours trading is also currently not available to Tele*Master users (touch-

tone phone investment service). The minimum after-hours order is for 100 shares, and orders must be entered in round lots (in increments of 100 shares).

Dreyfus Brokerage Services (www.edreyfus.com) ECN: MarketXT
1-800-416-7113
Commission: $15 per trade.

There is no minimum to open an account; however, DBS requires cash and/or securities in the account prior to placing an order; $2,000 is the minimum for a margin account. After-hours trades must be entered online via the Internet only. Phone orders are not accepted. DBS's online service is very bare bones without any fancy bells and whistles. You can get into the after-hours section site easily as a visitor and view sample screens. The minimum order is 25 shares, and the maximum order is 10,000 in increments of 25 shares.

Mydiscountbroker.com (www.mydiscountbroker.com)
ECN: MarketXT
1-888-882-5600.
Commission: $12 for limit orders up to 5,000 shares, plus an additional 1 cent per share for trades over 5,000. In addition, there is a 1 cent per share charge that will add a minimum of $1.50 and a maximum of $5.00 to each trade.

No initial deposit or account minimum is required to open an account on Mydiscountbroker, but sufficient cash or securities are required to be able to trade (see Figure 4-3). After-hours trades can be placed by telephone only. You can get to the after-hours center of Mydiscountbroker easily from its home page. From this center, you can choose to view the after-hours guide, which discusses after-hours trading in more detail, and view a list of frequently asked questions. In addition, you can view a list of the stocks available for after-hours trading on Mydiscountbroker. Customer service is available 24 hours a day both online and by e-mail, but by telephone only until 10 p.m. on business days. The minimum after-hours order is 25 shares, and the maximum order is 10,000 shares, only in increments of 25 shares.

FIGURE 4-3 *Mydiscountbroker web page*

National Discount Brokers Online (www.ndb.com) ECN: Instinet
1-800-888-3999
Commission: $19.75 per trade for up to 5,000 shares; 1 cent per share over 5,000 on the total amount of shares. Active Traders Advantage does not apply to extended-hours trading.

NDB lets you open an account without an initial deposit. When you want to trade, you can use NDB's simple online interactive application and begin trading as early as the next business day. Of course, NDB requires a certain minimum deposit before you can start trading. Trades may be placed only through an investor services representative. Extended-hours trading is currently not available online, and executed extended-hours trades may not be reflected at ndb.com until the next business day.

The after-hours section of the web site covers only the basics and provides a chart to show the differences between trading during the traditional hours versus after hours. Customer ser-

vice is available 24 hours a day, Monday through Friday, and from 8:00 a.m. to 6:30 p.m. weekends. The minimum order is 100 shares, and subsequent orders must be entered in round lots (in increments of 100 shares).

Fidelity Online (www.fidelity.com) ECN: REDIBook

1-800-544-6666

Commission: $30 for up to 1,000 shares, plus 2 cents per share over 1,000.

Fidelity requires a minimum deposit of $5,000 to open an account. After-hours trading is only available on Fidelity's web site. Fidelity automated service telephone (FAST) and Fidelity representative-assisted orders are not accepted, while web functionality is available. Fidelity allows customers who make 12 trades in a rolling 12-month period to reduce commissions to $14.95 ($5.00 premium for limit orders). If you already have a Fidelity account, you can access the after-hours trading section by logging into "My Portfolio" and clicking on the after-hours trading button. The minimum order in after-hours trading is 100 shares, and the maximum is 5,000 shares.

A.B. Watley (www.abwatley.com) ECN: Island

1-888-229-2853

Commission: $23.95 for Island executions plus 0.15 cents per share if executed on Instinet. A.B. Watley uses both Watley Trader (web-based trading) or UltimateTrader, proprietary trading software that allows you to connect directly over the Internet, including access to Level II data. Commissions are dependent on monthly trade volume, ranging from $12.95 to $23.95.

A.B. Watley, Inc. allows you to trade from 8:00 a.m. until 9:30 a.m. and from 4:00 p.m. until 5:00 p.m. These orders must be called into their trading desk. There are no share limits, but round lots are recommended.

10 STEPS TO AFTER-HOURS TRADING

1. Determine your personal financial goals and investment strategies.
2. Prioritize the services you want from a broker.
3. Know the ECN each broker routes its orders to.
4. Consider the type of trading you want to do (i.e., stocks, mutual funds, bonds).
5. Think about the type of account you want to open (i.e., cash, margin, IRA).
6. Choose an online broker that meets your needs.
7. Complete an account application and send in the minimum deposit.
8. Wait for your account number and temporary password.
9. Set up your permanent password.
10. Start trading.

YOUR FIRST TRADE

With the information we provided you so far, you probably feel you are ready to take money out of the bank and make your first after-hours trade. We urge you not to do anything until you have read the rest of our book, especially if this is your first experience with the stock market. In the next chapter, however, we will reveal a handful of 1-minute strategies you can use when you are ready to put your money to work.

SECTION II

HOW TO PLAY TO WIN

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1-MINUTE STRATEGIES FOR AFTER-HOURS TRADERS

Now that we have explained how to get started in after-hours trading, here comes the tough part: making money. It's easy to place a trade: After filling in the number of shares, the stock symbol, and your limit price, you press the enter key. Even if you're feeling empowered after reading the first few chapters of our book, you should not immediately go out and make your after-hours trade. Spend a few weeks watching the premarket and after-hours session with a close eye on the price and volume activity in the limit order books.

The after-hours session is different from the regular session, so it may take some time to get accustomed to it. To help you get started, however, in this chapter we will share some basic strategies, tips, and tactics. If you are already familiar with some of the trading techniques that follow, hang in there; we have a special chapter later in the book designed especially for more advanced traders.

Now we are going to reveal a number of short-term trading strategies specifically geared to the after-hours environment. Although this chapter is primarily directed at short-term traders, long-term investors can also use many of these strategies to boost their returns.

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DEVELOP A PERSONAL INVESTMENT STRATEGY AND STICK WITH IT

During the bull market of the past several years, we have seen many people, in almost a buying frenzy, latch onto stocks for all the wrong reasons. Whenever we meet people, their only questions seem to be about which stocks to buy. Naturally, they are looking for the next big stock, the one that will go from $2 to $100 in one day. But buying a stock just because it is going up, or because a friend recommended it, or because you heard about it on television, is no reason to buy it.

We believe it's important for you to know why you are choosing one stock over another. In fact, anyone who enters the stock market without thinking about or using a strategy is destined to lose money. Without a trading or investment strategy, you will not know why you pick one stock over another, and will meander aimlessly from one stock to another—probably losing more than winning.

That's why we suggest that, before you buy your first stock, you adopt some personal investment and trading strategies that make sense to you and can help to protect your assets. While clicking a mouse to make a trade is easy, making sound investment decisions is not. Nothing can take the place of good old-fashioned research and education when it comes to choosing where to place your hard-earned money.

If you are a conservative, long-term investor, by all means don't feel that you have to change your style to take part in after-hours trading. Select your stocks in the after-hours market just as you would in the regular market, based upon a company's fundamentals and potential for long-term growth. Likewise, if you are a short-term trader who wants simply to improve cash flow by making more frequent gains on your trades, choose your stocks as you would during the regular market. Either way, after-hours trading can be rewarding if you stick to a sensible, consistent strategy.

If you have never traded a stock in your life, however, you don't need to jump into the after-hours session. Start with the regular market session and develop some experience and basic

investment strategies to guide you before getting involved in the market. If you have a difficult time understanding the regular market, the after-hours market is going to be even more confusing. Nevertheless, with this book as a guide, you should be in a stronger position to increase your returns in the after-hours market when you're ready to participate.

USE EXTENDED-HOURS TRADING TO BENEFIT FROM NEWS RELEASES

Perhaps one of the greatest benefits of after-hours trading is the ability to take advantage of news that is released near the end of the close or outside of regular market hours. In fact, this is one of the main reasons that after-hours trading is becoming so popular so quickly.

Before after-hours trading, investors were virtually powerless to act on news announcements after the close. A likely scenario: If the news was negative, investors were forced to wait until the next day's market open before they could get out of their position. In the meantime, all the institutional traders were able to unload their stocks immediately via Instinet, which could drive the price down even further. More than likely, the individual investor was forced to take a loss the next morning when the stock opened up considerably lower.

In the opposite situation, if positive news was released on a stock after the close of regular market hours, retail investors were not able to buy the stock immediately after the news release. Institutional investors were the first to buy, driving the prices up by the next morning. Because of after-hours trading, you can now take advantage of news announcements that are released after the market closes.

However, to take advantage of breaking news announcements, you first need to have a fast and reliable source of news. While there are many places to search for news, there are basically only two different kinds of news services: real time or delayed.

Delayed news is the most common type of news service you will find on the Internet. There are many sites that offer free delayed financial news, including CNBC (www.cnbc.com), Bloomberg (www.bloomberg.com), CBS Marketwatch (www.marketwatch.com), and Yahoo! (www.yahoo.com). The problem with the free sites is the information may not be up to date enough for the active trader. Typically, delayed news feeds broadcast news that is at least 15 to 20 minutes old. A real-time news service, on the other hand, provides you with news as it is happening.

As you might expect, professional traders who have access to real-time news are in the best position to profit from breaking news. But by the time the average retail investor tries to buy or sell a stock based on delayed news, the stock has already made its move. Although delayed news may be adequate for buy-and-hold investors, short-term traders need immediate access to real-time news.

If you are serious about becoming a successful after-hours trader, we recommend you obtain a real-time scrolling news source. Scrolling means that the headlines are refreshed automatically without having to click the mouse. In our opinion, Dow Jones offers one of the most comprehensive and accurate real-time news, but news sources like Reuters or Bridge are also excellent choices. The cost for real-time news varies, so it pays to shop around. A web site we use for real-time news is Bridge, but you can do a search on your favorite Internet search engine to see if you find anything that you like better.

Once you are set up with your real-time news feed, you will be able to watch for news that might impact a stock you are in or looking to buy. The best time to look for news is during the last hour of regular market trading, after the market closes at 4:00 p.m., or before it opens at 9:30 a.m. News released during the last hour of trading will typically make a stock active during the after-hours session, as will news that is released at 4:00 p.m. EST. News released late at night or early the next morning can also give you a good opportunity to trade the stock before the regular market opens.

Once you have decided to place the trade, you simply enter your order, watch the order book, and decide on your exit strategy (unless you plan on holding the stock). Taking advantage of

news reports can be a good way to build your after-hours profits. To the uninformed investor, it seems like an easy way to make money, but it actually is harder than many people think. Read the next rule to find out why.

RESIST TRADING TOO QUICKLY ON BREAKING NEWS

Although you can now take advantage of breaking news in the after-hours market, it can also be dangerous to jump into a trade too quickly based on that news. Nowhere is this more true than when earnings are announced. Let's say, for example, that Intel reports that it beat analysts' estimates by 5 cents. Would you buy this stock in after-hours trading? Most novice investors would say yes and place their order as quickly as possible. In fact, many investors buy a stock thinking that it will automatically move up if the news appears to be good, or they sell short because they think a stock will automatically go down if the news is bad.

Unfortunately, we can never know for certain how the market will react to any news on any particular stock. We can remember dozens of situations where we expected a stock's price to go up on good earnings reports or good news, only to watch the price plummet.

Because you never know in which direction a stock will move on news, jumping into a trade can be hazardous. Earnings announcements can be a problem, because the average investor might not have all the information needed to make an informed decision. For example, the fact that Intel beat analyst expectations by 5 cents doesn't really mean that much. Intel has over 30 analysts covering it at any given time. To make an accurate prediction about the direction of stock, you would need to know what each analyst thinks, an impossible feat since estimates by First Call or Zack's are only averages. It is unlikely the retail investor will ever find out what individual analysts really think about the stock.

There is also a phenomenon called the "whisper number," which represents the fine-tuning of analyst estimates. As the end

of the quarter nears, analysts have better insight into a company's earnings and may disseminate a revised earnings number. Rather than issuing a new report with these changes, analysts issue a whisper number to their institutional clients, leaving the individual investor out in the cold.

Other factors also make it difficult for the average investor to determine what a stock will do after earnings are announced. Even if it logically seems like good news, the market may not react the way you expect it to. Before placing your order to buy or sell, we recommend that you wait for several minutes to see which way the stock will move. Although there is a chance you will end up paying a slightly higher price than you wanted to, at least the play is safer. Although taking advantage of news reports is one more way to build your after-hours profits, resist the impulse to jump right into a trade. Instead, wait to see in which direction the stock will go first; then make your trade.

HAVE A SELLING STRATEGY

Nearly all experienced traders and investors admit that deciding when to sell is one of the most difficult decisions they will have to make in the market. If you sell too early, you lose potential profits because the stock ends up going higher. If you wait until the stock has dropped in price, you end up selling too late, causing you to lose money. Some investors, like Warren Buffett, buy stocks they never plan to sell. But the rest of us must constantly grapple with the best time to sell. In fact, there never seems to be a satisfactory time to sell, because no matter what you do, you always feel you could have done better.

It is even harder to decide when to sell in the after-hours market. For example, if a stock you own is being run up fast in extended-hours trading, you have to decide if this is permanent buying momentum or just a temporary spike in the price. You could sell the stock on strength and go to sleep that night with extra money in your pocket. Or you could hold the stock through the night and not concern yourself with the short-term volatility of the stock. The answer really depends on your strategy. If you are a long-term buy-and-hold investor, you would probably hold

the stock and patiently let the price climb higher. If you are a short-term trader, you will look at technical data to determine if the gapping price is sustainable. For example, if a stock is rising quickly on low volume, this is a clue to short-term traders that the stock should be sold. We often use the premarket or after-hours market session to look for price spikes on the stocks we want to sell, trying to scalp a few extra points from temporary buying enthusiasm.

Sometimes even dream stocks turn into nightmares if you make the wrong selling decision. This is what happened when we owned the Swedish telecommunications company, Ericsson. We picked up the stock of this superb company at $19 a share for a long-term hold based on a recommendation from our Swedish friends. We sold the stock a few years later for a tidy profit when it rose to $30 a share. However, the last time we looked, it blew past $90 a share, caught up in the telecommunication mania that swept the world. It still makes us angry we didn't hold this stock for the long term instead of selling it for a fairly quick profit.

Our best advice is to spend the time to devise a sensible selling strategy. As most pros know, it is incredibly easy for people to buy stocks, but choosing the best time to sell is what separates the winners from the losers.

CHOOSE AN ECN WITH THE MOST LIQUIDITY

With so many ECNs to choose from, which one should you choose? First of all, you should choose an ECN that has a significant number of orders. Therefore, if you want to be an active after-hours trader, we recommend that you pick a broker that works with an ECN that offers sufficient liquidity. At least until all the ECNs join forces, the older and more established ECNs, like Instinet and Island, are the most liquid, although REDIBook and MarketXT are gaining liquidity and will be accessible through more retail brokers. Greater liquidity means that more people will be trading, which will increase your chances of getting your order filled promptly.

Another factor in choosing an ECN is finding one that allows you to trade the stocks you want at the times you want to trade them. At this time, only stocks can be traded in the pre-market and after-hours sessions. Options, bonds, and mutual funds are not yet available for after-hours trading, although this will likely change sometime in the future.

However, not all stocks are available to trade on every ECN. Until the ECNs agree on a standard set of after-hours rules, there will be differences regarding both the hours of operation and the type of stocks allowed for trading. Be sure to pick an ECN (and associated broker) that allows you the most flexibility with the stocks you want to trade at the hours that are most convenient to your schedule.

TRADE STOCKS THAT ARE SHOWING RELATIVE STRENGTH AFTER HOURS

Relative strength is when a particular stock or market sector is trading stronger than the overall market as a whole, typically using the Dow Jones Industrial Average (DJIA), the S&P 500, or the Nasdaq composite as the market indicator.

For example, if the Dow took a major drop for the day, but the stock you are in is up for the day, you could say that the stock has relative strength because it is strong relative to the market. In other words, if the stock can close positive in the face of lots of selling in the market, then the stock is strong relative to the market. This same principle would hold true whether you were comparing the stock with the Dow Jones average, the S&P 500, the Nasdaq, or any other market indicator.

Likewise, if the Dow closes positive for the day, any stock or sector that closes at a higher percentage up from the Dow could be said to have relative strength. For example, if the Dow rose 1.2 percent for the day, but the stock you are in rose 3.4 percent, then you could say that the stock has relative strength, which would be a good stock to buy after hours.

The bottom line is that since we never know for sure which way the market is going to go, you can sometimes protect your-

self from huge losses in after-hours trading by buying only stocks that have demonstrated relative strength in the regular trading session. Conversely, if a stock is showing relative weakness, you should sell if you own it or sell short if you don't. Relative weakness, therefore, refers to stocks that are weak compared with, say, the S&P 500 or the Dow. If the Dow is up by 2 percent and your stock is down, it is weak relative to the market. These are just some of the technical indicators that many short-term traders use to determine when to buy or sell a stock.

TAKE ACTION AT THE MARKET CLOSE

Just because the bell rings doesn't mean the markets are closed. A stock that is rising right before the market close will likely continue on its upward trend. Trading momentum does not stop exactly at 4:00 p.m., and strong buying or selling at the close of the regular market often continues into the after-hours session.

There are two strategies you can use to take advantage of this scenario. If you are an aggressive trader, you could buy a stock before the close with the intention of riding the upward momentum through the after-hours market and into the next day. Buying stocks on momentum can be a quick way to make money, although this strategy takes skill and experience. Is the buying or selling conducted on low or high volume? If there is high-volume trading, the momentum will likely continue into the after-hours session.

Nothing is more fun than watching the prices of your stocks in the limit order book leapfrog over each other seemingly to infinity. One of the reasons the after-hours market is so fascinating is that certain stocks can take off after 4:00 p.m., especially when liquidity is low and interest is high. As long as you don't chase after these high-flying stocks, you can find many opportunities to take advantage of short-term after-hours exuberance.

Another strategy is to take advantage of a strong close by selling a stock that you currently own during the after-hours market. As the momentum of the stock carries into the after-hours market, it could be a good time to close out your position.

Fewer participants mean liquidity will be lower and price volatility will be greater. Often, stocks move quickly on low volume. A quick rise in the stock price could provide you with a nice profit.

Although there are no guarantees, it is also possible the momentum will carry into the next day. Perhaps in this case it is better to take your profits off the table, taking advantage of the irrational exuberance that often follows a strong close. Conversely, a stock that is closing weaker at the market close will likely continue in that direction into the after-hours market. In this case, you don't want to sell your stock in a panic even though your stock might experience a short-term drop during the after-hours market. If you are an aggressive trader, you might see this falling stock as a buying opportunity.

One of the difficulties with the after-hours market is that you don't know what will happen to the stock the next day. The after-hours market could be a great place to pick up bargains from panicked sellers, although it could also be an indication of what is going to happen the next morning.

TRADE NYSE STOCKS

Most of the top traders and investors have learned through experience the type of stocks they're most comfortable with. For example, some traders prefer the NYSE stocks, because they are often less volatile than Nasdaq issues and somewhat more predictable. The reason they are relatively stable is that the NYSE includes the stocks of some of the largest and most well-known companies. The bluest of the blue chips reside in the NYSE, including IBM (IBM), GE (GE), and Xerox (XRX).

Although for years the NYSE stocks were not allowed to trade on the Nasdaq or alternative trading platforms like ECNs, the rules were changed at the end of 1999. Now NYSE stocks can be traded on any exchange or market, including the premarket and the after-hours market. If you want highly liquid, predictable stocks that you could hold for a lifetime, then NYSE stocks are for you.

If you do decide to focus on NYSE stocks, do what the pros do. Learn everything you can about the company in which you are interested. Study the fundamentals. For example, find out who is managing the company, what its quarterly and yearly earnings are, and what its current P/E ratio is. If you are a short-term trader, spend the time to study charts to determine technical strength or weakness. By looking at a chart, you will also get a good idea of the average trading range of the stocks in which you are interested.

If you are not sure which NYSE stocks to study, pick out the market leaders, the kind of stocks that are growing the most each year and are the strongest in their sector. It makes no sense to invest your money in companies that are consistently lagging behind the competition. Instead, look for the strongest, fastest-growing companies with the most potential for future success.

TRADE NASDAQ STOCKS

The Nasdaq Stock Market, unlike the NYSE, contains a lot of up-and-coming technology companies, as well as many old favorites, like Microsoft (MSFT), Cisco (CSCO), and Apple (AAPL), and a huge number of Internet and biotech companies. Nasdaq stocks, characterized by their four- and five-letter symbols, are generally more volatile, which is why many short-term traders prefer them to NYSE stocks. Nasdaq stocks allow aggressive traders or investors tremendous opportunities to make or lose money on wild price swings and volatility. In the after-hours market, some of these stocks get even wilder, so you really have to be cautious. Once again, your best defense is to learn everything you possibly can about the stocks you want to trade.

As with NYSE stocks, use both fundamental and technical analysis to determine which stocks to buy or sell. The market leaders in each sector should be your first choice, especially if you are a new investor. Keep in mind that the after-hours market, no matter what stock you pick, can sometimes get a little crazy. Nasdaq stocks that are volatile during the regular market could turn into dynamite after hours, so our best advice is to handle these swinging stocks with care.

BUY STOCKS AT COMPETITIVE PRICES

This sounds like an obvious strategy, but many investors do not spend the necessary time required to buy stocks at the most favorable prices. Perhaps to save time or because of overexuberance, many investors are willing to pay the highest prices for stocks, collectively losing millions of dollars every year.

One of the most important features of after-hours trading is that you can decide how much you are willing to pay for a stock. The problem is, how do you know what the most competitive price is? Let's say you want to buy Cisco Systems (CSCO) after hours because you heard it was going to split. Before placing an after-hours trade, be sure to check the closing price of CSCO on the Nasdaq. Then, view the limit order book on your ECN. The book should show you the best bid and best offer price available on the ECN at that time. You can then set your limit order accordingly.

For the fastest fill, some pros say to put in a limit order that is a ¼ or ⅛ point above the current bid or ask price. You will usually get filled immediately at the lower price, even faster than if you had put in a market order. In this case, you are trading a potentially higher price for a fast order fill.

An alternative strategy, if you want to buy a stock at a competitive price, would be to enter your limit order at or a few points below the current best bid price. You may not get the stock at the price you want, but perhaps if you wait long enough, you just might. This follows the most profitable and basic rule of investing: Buy low and sell high.

Conversely, if you want to sell a stock you currently own, put in a limit order at or a few points higher than the current price. You might have to wait longer than a night to get filled, but it's worth the wait if you can sell the stock you own at a better price. Although you might not get matched immediately, if at all, at least you are controlling how much you are willing to pay for a stock.

If you are using the after-hours market to buy a stock for the long-term portion of your portfolio, then you should not be in a rush to buy the stock. Decide what you are willing to pay for it

and place a limit order at that price. Keep in mind, too, that after-hours prices can vary significantly from one ECN to another. While we realize it isn't feasible for you to compare prices on all ECNs, you can always stay tuned to CNBC, which continues its coverage by quoting some of the most active stock prices on the various ECNs, most notably Island, Instinet, REDI-Book, and MarketXT.

The premarket and after-hours market are good places to find bargains on your favorite stocks, especially when panicked investors sell based on breaking bad news. If you own shares of stock in companies like Oracle, Nokia, Texas Instruments, or Sun Microsystems, you could use the after-hours market to buy more shares when the prices of these stocks fall. Savvy investors will scan the after-hours market looking for good deals. We have learned from experience that you will have dozens of opportunities to buy stocks at lower prices if you are willing to wait.

STICK TO STOCKS THAT HAVE THE MOST VOLUME

Many novice traders aren't aware of the importance of volume in deciding whether to go long or short a stock. Basically, volume refers to how many shares of a stock traded hands during the course of any given period, usually a day.

Knowing the average volume that a stock trades is important because it can help you identify trading opportunities. For example, higher-than-average volume for a stock on a particular day or night indicates an increase in investor interest. If a stock's intraday volume is higher than average, this is generally considered to be the best type of stock to trade because there is larger-than-usual buying or selling interest in that stock. If the stock were rising on high volume, you would be inclined to go long.

If, on the other hand, the intraday volume of a stock was lower than average, it could be risky to trade that stock. A stock with lower-than-average volume can quickly and easily reverse

direction if a number of buyers or sellers suddenly come into the stock. For example, if you are long a stock that is trading at half of its average intraday volume, one large seller who dumps his shares would likely cause the stock to dip quickly. Should the same thing happen with a stock that is rising on higher-than-average volume, there would generally be enough buyers to absorb the sell orders, even if large blocks of sell orders come through. In other words, it is almost always safer to trade stocks that are showing higher-than-average volume, because the downside risk is lower.

Moreover, low-volume or less active stocks in the after hours tend to be even less predictable. It is virtually impossible to tell in which direction they will go. Once again, this is because it only takes one large buyer or seller to negatively (or positively) impact the direction of the stock. Conversely, stocks that are trading on higher-than-average volume after hours are more likely to continue in a steady direction, which will increase the odds of making a profitable trade.

By sticking with stocks that have higher-than-average volume, you are at least minimizing the risk of a stock reversing direction unexpectedly. If a stock is trading on high volume, it also means there is more liquidity in that particular stock. With more liquidity, you will generally have a better chance of getting your order filled quickly.

USE THE LIMIT ORDER BOOK TO MONITOR THE MOST ACTIVE STOCKS

Since we suggested that you stick to the stocks with the most volume, and therefore are the most active, we now want to show you how to identify them. Perhaps the easiest way to know which stocks are showing high volume after hours is to use the "most active" features found on many of the ECNs. At this time, Island, MarketXT, REDIBook, and Instinet are the only ECNs that publicly display lists of their most active stocks on their web sites.

The most active page of the Island web site allows you to view the top 20 highest-volume stocks being traded on that ECN. You can see the top 20 most active stocks both during regular market hours and during after hours. One nice thing about Island's most active list is that it also allows you to customize how the top 20 are sorted. You can sort by any number of different criteria, including the number of shares traded and the most active stocks.

MarketXT also lists the top 10 most active after-hours stocks on that ECN, along with a price quote. Instinet's web site, like Island's, displays information about its most active stocks, beginning in the premarket until the close of trading in the evening.

USE THE PREMARKET TO EXIT LONG POSITIONS

Although we have primarily talked about the benefits to trading after hours, you have just as many opportunities in the premarket to exit positions you are holding in your long-term portfolio.

Many companies release significant news a few hours before the market opens each morning. As a result, there is often a knee-jerk reaction to the news, especially when it is announced on CNBC. Immediately, all the novice traders start buying in an attempt to beat the crowd. What many of these traders don't realize is that other traders are waiting for a pop in the stock so they can exit their positions. News that appears positive to many novice day traders might be considered as negative by Wall Street. In this case, the pros will sell their position, perhaps even shorting the stock. In either case, you might find yourself trapped on the wrong side of a trade.

Instead of trying to chase after stocks that are gapping up in the premarket due to news releases, do the opposite. Use the temporary price spike as an opportunity to sell your stocks into strength. It is possible you'll get the best price during the premarket or in the first few minutes of the opening.

AVOID TRADING HIGHLY VOLATILE STOCKS

Volatility refers to the changes in price that stocks undergo when trading. The higher a stock's volatility, the wider its price swings. Because of the lower liquidity during after-hours trading, there may be more volatility than usual, and therefore, wild price swings. While there is no doubt that you can make a lot of money after hours by trading stocks that move from one price extreme to another, if you are not an experienced trader, we advise you to be cautious of these highly volatile stocks. Of course, if you are an experienced trader using technical analysis to help predict price and volume activity, these are the kind of stocks you could fall in love with. If this sounds like your kind of stock, you may be better off reading the advanced strategy section in Chapter 9 for tips on taking advantage of these huge price swings.

If you are a novice investor, however, it's best to avoid trading the kind of stocks that can make your heart jump, the kind that will move 50 percent in one direction or another. Although there is a saying in the industry that "risk creates opportunity," we believe that managing risk is the key for long-term success. Even professionals, who rely on technical charts or fundamental information to determine the best time to enter and exit a position, say it's not easy to profit from sudden price movements. Rather than spend your time trying to chase a swinging, volatile stock, we believe you should use your time to analyze trading opportunities that will bring you the best chance for success. Buying the most volatile stocks with the hope they will rise in price is more akin to gambling than trading.

USE LONG-TERM DAY TRADING STRATEGIES

A long-term day trading strategy is one in which you use a combination of two investment strategies, one long term and the other short term. With this style of investing, the majority of your

portfolio will be in high-quality stocks, mutual funds, and index funds. The remainder of your portfolio will be used for short-term trading tactics. You then use both fundamental and technical information to decide what stocks to buy and sell. Long-term day traders might keep 50 to 70 percent of their portfolio in a mutual fund or the stock of a well-established company. The other 30 to 50 percent will be used for short-term trading, including after-hours trading. These percentages are flexible depending on your trading capital, financial goals, and risk tolerance.

For example, you could buy 1,000 shares of Vitesse Semiconductor (VTSS), which we did when it was $20 a share a few years ago. Using the long-term strategy, you would buy a core number of shares, say 500, and hold them for the long-term portion of your portfolio. Then, with the remaining 500 shares, you would use short-term trading tactics, buying and selling for smaller 1- to 5-point profits. You would then add to or reduce shares as the price rises or falls, never selling less than your core position. By combining both long-term and short-term strategies, you take advantage of short-term price fluctuations as well as following the sensible buy-and-hold strategy advocated by most professional investors and mutual fund managers. For us, the perfect stock is one we can keep in both our long-term and our short-term portfolio. There is no rule that says you have to confine yourself to only one strategy, and long-term day trading allows you the flexibility to use both short-term and long-term tactics in one portfolio.

DO NOTHING

Matthew Andresen, president and CEO of Island ECN, told us that after-hours trading really bothers his mother. Like many people, she doesn't like the idea that her stocks are moving while she's asleep. It is likely that the idea that your stocks are moving after the market closes is disconcerting to many of you as well.

On the other hand, thanks to the miracle of a real-time streaming portfolio and an active after-hours market, you can watch the value of your portfolio rise or fall throughout the

night. It is always a thrill to wake up the next morning a little bit richer. Conversely, if your stocks aren't trading as well as you expect, you could get out of bed with a little less cash in your account.

Unbeknown to a lot of people, stocks have been moving in the middle of the night for years, caused by the pros who have been trading among themselves. Now, for the first time, instead of having to idly watch from the sidelines, you can join in. This doesn't mean, however, that you must participate. We have learned the hard way that sometimes the smartest strategy is to just let your stocks be, especially if you are a long-term buy-and-hold investor.

FIND OUT WHAT THE PROS ARE BUYING

If you aren't sure where to get good stock ideas, instead of listening to acquaintances who are part-time investors, find out what the pros are buying or selling. Obviously, you can watch CNBC, CNNfn, *Bloomberg Moneycast, Fox Business News,* and *Wall $treet Week with Louis Rukeyser. Investor's Business Daily,* the *Wall Street Journal,* and *Barron's* are also excellent sources of information. You can also log onto a number of web sites such as www.MidnightTrader.com, www.TheStreet.com, and www.afterhourtrades.com to find out which stocks are favored by institutional investors in the after-hours market. When people ask us for stock tips, we always direct them to www.bigtipper.com, which displays and rates tips from well-known investors. Of course, you should not buy a stock just because someone recommends it unless you research it—what many pros call doing your homework.

If you find out that a major institutional investor is interested in a particular stock, momentum will definitely increase, especially when short-term traders find out about it. It is smart trading to keep a close watch on what the pros are doing, and to determine if their stock selections fit into your overall trading and investment strategies.

STUDY THE TREND OF THE MARKET

The most profitable short-term traders look for indicators that determine the trend of the market and then trade accordingly. Your first clue will be with the S&P futures, which will be displayed during the premarket session on most financial television programs. The S&P futures are closely watched by the pros to determine in which direction the market might go.

Short-term traders are looking for divergent patterns, that is, a stock going in the opposite direction of the S&P futures. This is a useful way to find stocks to buy. For example, if the S&P futures are falling, and the stock you're following is rising, this divergent pattern is a sign of strength. This is definitely a stock you should consider looking at. If the stock is also showing strong volume, more than its daily average, you should consider buying it. Savvy short-term traders would likely notice the divergent pattern and run the stock up even higher.

Conversely, if the S&P futures are strong and a stock you own is going in the opposite direction, you might consider selling, especially if you are a short-term trader. If the stock is heading down and volume is strong, this probably reflects heavy institutional selling. If you are a long-term investor and you still feel the stock is a good value, this short-term activity won't concern you. Short-term traders, however, might think about selling their shares.

INVEST IN STOCKS THAT ARE ADDED TO THE S&P OR DOW

As soon as you hear that a particular stock is going to be added to the S&P or Dow, you might want to think about buying it. If news of this announcement comes after the closing bell, the stock will likely go much higher in the after-hours market. Initially, short-term traders will buy and sell quickly as soon as the stock gaps up or rises quickly, perhaps causing the stock to fall back to its previous price. So this could be a profitable one-night play for short-term

traders. This is just the kind of late-breaking news announcement that could do wonders for your portfolio. In addition, hundreds of professionally managed index fund managers will be forced to pour new investor money into these stocks. If you are a long-term investor, these will be ideal stocks to add to your portfolio.

USE CHARTS TO MAKE BUY AND SELL DECISIONS

You probably know there is some controversy over whether charts can help you decide the ideal time to buy or sell a stock. Critics claim that charts only reflect the past and can't possibly predict what a stock might do in the future. Our view is that in the hands of a skilled technician, charts are extremely helpful in determining the short-term direction of a stock. In the stock market, sometimes history does repeat itself. By studying price and volume and technical indicators like support and resistance, as well as chart patterns, you can discover ideal entry and exit points.

We have learned to consult a chart before we buy or sell a stock, even if it is for the long-term portion of our portfolio. For example, the next time you get a hot stock tip from your next-door neighbor on the next new technology company, look at a chart of the stock. It will only take a few seconds to discover whether this stock is falling faster than a knife.

So far, it has been a challenge to find charting software that works in the after-hours market. However, we have heard that a number of companies are developing charting software for the after-hours market. Until the software is completed, the following web sites provide excellent charts for the regular market: www.bigcharts.com and www.quote.com.

BE A NIBBLER

Too many people jump into after-hours positions without taking the time to analyze volume and price movement. In the after-hours

market, it could be financial suicide to take a huge buy or sell position without first understanding what is happening with the market. Instead, we recommend that you become what we call a "nibbler." If you have your heart set on a particular stock, instead of buying 1,000 shares, buy only 100. If you're matched immediately, this could be an indication your price isn't competitive.

Study the limit order book to see if buying or selling interest is building in the stock. If buying interest is growing, you can always put in an order to buy more shares at a lower price to see if you're matched. The point is, be cautious. Professional and institutional traders nibble all the time, and you can benefit from doing it, too. We know of several pros who put out 500- and 1,000-share orders to feel out the market before they enter a relatively large 10,000-share order. Be like the pros and stick your toe in first with smaller orders.

BE PATIENT

One day we'd like to write an investment book in which we don't have to remind people to be patient. But as long as humans are trading stocks, that day will likely never come. And when it comes to after-hours trading, you may require an even larger dose of patience than usual.

Remember, you can only place limit orders in the after-hours sessions. This means that you must enter the price at which you would like your order to be executed before your order can be accepted. If the market moves away from your price, your order may not be executed. Likewise, if similarly priced orders from other investors come in before yours, they will beat your order to the limit order book, and may prevent your order from being matched. In addition, if your order is not executed by the end of the after-hours session, it will expire (unless you enter a good until cancelled order). Then you will be required to re-enter your trade all over again the next time you want to trade. Sometimes you will put forth a lot of effort and have nothing to show for it at the end of the day.

As you see, it takes patience to be an after-hours trader, which is also a characteristic of the best investors. Be patient

with your winners and impatient with your losers. If you have the patience to give your trades time to work, you will likely be rewarded with extra profits at the end of the day. Although seconds seem like hours when you are a short-term trader, after you make a trade, force yourself to wait and watch. If you must be impatient, save it for equipment failures, slow order execution, and dumb mistakes.

HOW TO WIN THE STOCK MARKET GAME

We have always wondered why some professional traders consistently make money in the stock market while others lose money and are eventually forced to give up trading altogether. Although there are various reasons why some people go to sleep with more money in their trading account than others, in the next chapter, we will closely examine the characteristics of the most successful traders to see what it takes to win this fascinating game.

6

CHARACTERISTICS OF WINNING TRADERS

Imagine how much easier your life would be if you knew that you could make money for yourself and your family almost anytime you wanted. Even though it seems like an impossible dream, that's exactly what some of the top traders in the country are able to do. Although it takes knowledge, experience, and an incredible amount of discipline to consistently win in the market, thousands of successful traders have proved it is possible to have it all—a flexible, fun work environment and huge financial rewards. In this chapter, we are going to reveal the characteristics that winning traders possess and the steps you can take to acquire those characteristics.

One of the most fascinating secrets is that the most successful traders accept the fact that they will lose money. That's right—before you can win in the market, you have to learn how to lose. Since you know you are going to lose money in the market, because everyone does, your goal is not to make more money, but to lose less. In other words, you must learn how to lose less money on trades that go against you. This is the difference between pros and amateurs; the pros work hard to control and minimize their losing trades. It takes skill and experience to end the day with small losses. Unfortunately, learning how to

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minimize losses is one of the most difficult skills for traders to learn.

When we are talking about the after-hours market, it is even harder to be successful. Anyone who trades in the after-hours market knows it alternates between wild and boring, a difficult environment for even the most experienced traders. If you make a mistake in the regular market, there is enough liquidity to get you out of a position, perhaps bruised but intact. In the after-hours market, a really dumb mistake can cost you dearly. As most pros know, it takes more than skill to be a successful trader. To consistently make money in the market, you need a combination of characteristics, which we will describe later in this chapter.

The good news for you is that the information we give you can be applied to all market environments, not just the after-hours market. It doesn't matter if you are a short-term trader or long-term investor; the characteristics we include in this chapter should help give you the knowledge you need to win this game. Therefore, the purpose of this chapter is twofold. First, to teach you what you should do in the market. Second, to teach you what you shouldn't do. However, it's not as easy as it sounds.

THE DISCIPLINED TRADER

If you have read other investment books, you probably know the reasons most people lose money in the market. For example, nearly every book, including this one, mentions discipline as the primary reason why some traders go to sleep with profits and others wake up with huge losses. It is so easy to tell people that if only they had a little more discipline, they would make more money. We think that acquiring discipline is about as easy as finding happiness. The more you search for it, the harder it is to find. And yet it is obvious that winning traders are doing something right, and being disciplined is the likely reason.

To us, discipline means having enough skill to know what to do (the easy part) and the willpower and courage to actually do it (the hard part). In the stock market, this means having an investment strategy and trading rules, and most important, being

able to stick with your strategy and obey your rules. Many people know what to do, but for one reason or another, fail to follow through.

Most people agree it is incredibly difficult to be disciplined when your stocks are going up and down like a roller coaster. In one night, you could make more money than you have all year or end up with a handful of nearly worthless paper. If you aren't disciplined, you might as well take out your wallet or purse and hand over your money now, because you're going to lose it. If you lack discipline, the market is going to beat you.

We wish we could tell you that it's easy to acquire discipline. The truth is, it comes naturally to some, but for others, it's a daily battle. As a trader you will face constant challenges and experience a wide range of emotions. It reminds us of the conflict that Mr. Spock from *Star Trek* faced. As you remember, he was part human and part Vulcan. The struggle between being a human with instincts and feelings and an emotionless creature from another planet is exactly what it's like to trade in the stock market. If you want to make money in the market, you will have to trade more like a Vulcan and less like an Earthling.

It would be nice if there were an easier way to acquire discipline. Unfortunately, rather than being the easiest characteristic to develop, it is actually the hardest. What we've tried to do is come up with a few steps to help improve your discipline. We have learned that it is hard enough to be disciplined during the day, but it's even harder at night. If the after-hours market is really the Wild West, as some critics claim, then shooting from the hip will get you killed. Should you be afraid to trade in the dark? Not at all, because we know you're going to read every word in this chapter before you trade stocks at night.

Here are some tips about discipline:

STEP 1: BE EMOTIONLESS

When you commit money to the market, you have unconsciously agreed to commit your emotions. Although money is actually multicolored paper, on a psychological level, it represents much, much more. For example, the amount of money you make or lose in the stock market could influence how you feel about yourself,

what plans you have for the future, or whether you'll be visiting the shopping mall this weekend.

Disciplined traders try to minimize emotions and treat the buying and selling of stocks as just another day at the office. They try not to get emotionally involved with their trades. The less you take your wins or losses personally, the more effective you will be as a trader. It is always a danger signal if you are getting a bit too giddy when you're making winning trades or when you find yourself crunching keyboards or yelling when you lose. The market is unforgiving to undisciplined, emotional traders.

There are traders who think they are geniuses when everything seems to be going their way. Some of the top traders in the country, who are always on guard for unusual emotional responses, often stop when they've had too many days of successive wins. One of the keys to being disciplined is being humble, that is, to take your winning and losing days in stride. The sooner you treat trading stocks as a business, the more productive you will eventually be as a trader. Most winning traders don't get overly excited when they are winning, nor do they get depressed when they lose.

Often, novice traders are delighted to be making even small profits, perhaps $100 or $200 a trade. Perhaps they aim for conservative 15 or 20 percent annual returns, which is reasonable, especially when you are first starting out. Then greed takes over, making us want much, much more. Soon, we aren't satisfied with such paltry returns. Like an addict in need of a fix, we need more profits to satisfy us. Instead of 15 or 20 percent returns, we won't be satisfied unless we double or triple that amount.

Just as dangerous is fear, especially when the entire market takes an unexpectedly nasty turn to the south. The feeling that we are going to lose all our money if we don't act immediately can force us to make huge mistakes, like selling all our stocks at fire sale prices. When you become overwhelmed by fear, there are thousands of other investors eager to buy your stocks. By the time your feelings of panic have subsided, it's usually too late. You have already sold your stocks at ridiculously low prices.

The top traders know that fear and greed, if left unchecked, can ruin even the most brilliant portfolio. The sooner you realize that fear and greed are your enemy, the sooner you will tell your-

self not to get emotional when trading. On the other hand, it is important to recognize and take advantage of the fear and greed in other traders. If you understand the relationship between psychology and the stock market, you will be in a stronger position to profit during all market conditions. Winning traders know that emotion moves stock prices, at least in the short term. The sooner you realize that stocks move based on the perception and beliefs of other people, the sooner you will rise above the noise and do what you think is right.

Oliver Velez, CEO and cofounder of Pristine.com, a firm for self-directed traders, said that you are not trading stocks, you are trading people. Behind every stock are people buying and selling based on fear or greed, and sometimes both at the same time. Therefore, you must understand the psychology of your opponents—the other traders—and not let your emotions influence your trading decisions. It's okay if the other guy gets overly emotional when trading stocks, but don't let it happen to you. The traders with the most discipline and the least amount of emotion ultimately win.

If you are a disciplined trader, you could use the after-hours market to buy stocks from or sell them to overly emotional traders. Some panicked traders might use the after-hours market to desperately unload all their shares, especially if a stock started falling during the regular session. You should always be on the lookout for quality stocks that are being driven down by investor fear. The disciplined trader is not going to be flushed out of a position because of a temporary price drop. We can think of many stocks, for example, Intel and Apple, that lost millions in market value as panicked investors sold out. Of course, both stocks bounced back even stronger a few months or years later. If you can keep your head in the market while others are not, you will be richly rewarded for your efforts. Taking advantage of the psychological errors of other traders offers you one of your best chances for success in extended-hours trading.

STEP 2: START A TRADING JOURNAL

The key to successful trading is the ability to objectively analyze your trades. This means having the courage to study your win-

ning and losing transactions to see what you did right or wrong. Many top traders concentrate only on their losing trades because they know you learn more from your losers than your winners.

An effective way to uncover errors and to counteract the twin forces of greed and fear is to create a trading journal. Many top traders routinely write their errors down in a journal at the end of every trading session. The goal is to find trading errors that you repeatedly and often unconsciously make. When you have a journal, you will begin to uncover all kinds of useful information. For example, some traders discover they lose more money on Fridays than on any other day, or that August is always their worst month. In this case, the journal will inspire them to take corrective action.

You should have a journal no matter what your investment style. For example, if you are a long-term investor, you might buy 100 shares of IBM because you believe in the company's products. Your long-range plan is to hold the stock until you retire. Unexpectedly, IBM drops by 20 percent a few months later and you consider selling all your shares and cutting your losses. If you kept a journal, you could review your reasons for buying the stock in the first place. You'd remember that you bought it as a long-term investment, not as a short-term trade. The journal would help you stick to your original game plan no matter what happens in the market.

It is difficult for some people to closely analyze their feelings, especially when they make a mistake. As you know, it's always much easier to analyze the mistakes other people make rather than your own. If you find it too difficult to analyze your trades on paper, then work closely with a trading buddy who will guide and protect you while trading stocks at night. A knowledgeable friend with your best interests in mind can do wonders for your portfolio.

You can also use a journal to uncover your mistakes and weaknesses. Some traders, to help uncover unconscious mistakes, give themselves a grade for every trade they make. This is a fast and effective way to discover repetitious errors that interfere with your ability to make a profit. You can use your journal to help learn some of the nuances of this new trading environ-

ment. Get in the habit of reviewing your journal every day. You can use it to get new ideas and keep a record of how certain stocks are being traded. The sooner you learn the personalities of the stocks traded during the after-hours session, the more of an expert you will become. You will be amazed at how much you will learn by keeping a record of your trading experiences.

STEP 3: IGNORE STOCK TIPS

When you are disciplined, you don't buy stocks based on worthless tips or loose talk in an Internet chat room. You know the quickest way to lose money in the market is to listen to uninformed acquaintances, cold-calling stock promoters, and online strangers. The open-forum chat rooms are probably the worst place for advice since you have no idea whom you're talking to. It could be other investors trying to convince you to buy stocks they mistakenly bought, or professional scam artists trying to pump up interest in the low-priced stock of a nearly bankrupt company. They know how to press the greed buttons to convince you to buy the junk they have for sale.

Even though this is not new advice, it is good advice. Millions of dollars are lost every year in the market by people who listened to misguided recommendations from friends or strangers. It takes discipline to keep your ears shut, but it is the best advice we can give. If the only reason you are buying a stock is because it was recommended by a friend, then you should take a pass.

Once we got a call from a friend who urged us to buy a "can't lose" stock, which was a recommendation from her stockbroker boyfriend. Our instincts told us we should ignore this tip, but our friend was so sure about the stock we decided to buy it. Perhaps this time was different. By the end of the week, we quickly lost a third of our initial investment as the stock plummeted. We immediately sold the stock to cut our losses. It was the last time we ever bought a stock based on a tip. Sadly, what happened to us is a common occurrence. When you are a disciplined trader, you ignore stock recommendations no matter how sexy and exciting the story sounds. It is much more profitable to

find your own stock picks and not depend on people who know less about the market than you do.

One stock that could be hazardous to your wealth is the over-the-counter bulletin board (BB) stock. So far, these stocks have not been included in the after-hours market, but this could change in the future. Many of these companies are not required to report to the Securities and Exchange Commission, so finding out anything about the company can be difficult. Company financials are not readily available and may not disclose the full picture. These over-the-counter BB stocks are often referred to as "penny stocks" because so many of them are typically less than $5 a share. Because these stocks are so illiquid, even in the regular market, it would be too easy for other traders to manipulate them. Penny stocks are easily susceptible to false chat room rumors, fake press releases, and cold-calling strangers.

A now-defunct South Florida brokerage used to generate dozens of "positive" press releases to unsuspecting investors touting the stock of the week. The sudden flurry of news stating that a brokerage was "initiating coverage" on a stock was used to convince unsuspecting victims into buying the stock. Like all things that are too good to be true, as soon as the stock reached its all-time high, the insiders sold all their shares, causing the stock price to crumble. This is just one of the many problems with penny stocks, and the after-hours environment will only exacerbate it. Even short-term traders tend to avoid the penny stocks, primarily because once you get in, it's difficult to get out. It's hard to sell a stock when all the buyers have disappeared. Like a game of musical chairs, or a good old-fashioned Ponzi scheme, the retail investor is often the last one standing.

Our best advice is to avoid trading penny stocks no matter what market they are traded in. We have friends who've spent years looking for gold in the land of the pennies, but always come up empty-handed. These stocks are cheap for a reason, and it's because the smart money has found other companies to invest in. Remember that in the stock market, you usually get what you pay for. This is especially true when you are buying penny stocks. A good web site devoted to uncovering stock fraud among penny stocks is www.stockdetective.com.

If you insist on trading on tips, then turn on CNBC, CNNfn, *Bloomberg Moneycast,* or *Wall $treet Week with Louis Rukeyser.* These programs give you an effective way of emulating the successful men and women who have investment styles that make sense to you. At least the guests giving the tips are generally professional investors and have likely done the necessary research. A good web site devoted to stock tips is www.bigtipper.com. It tracks tips from a variety of professional analysts and fund managers, even ranking the experts according to how their tips panned out. This is the web site we give out when people ask us for tips, because we have learned the hard way it is just as harmful to give tips as it is to receive them.

STEP 4: CONCENTRATE ON WINNING

When you are a disciplined trader, you do not let anything distract you from the business of making money. In the after-hours market, this means you do not trade stocks while you are eating dinner or talking on the telephone. One of the fears of the SEC and other organizations that look out for the interests of retail investors is that people will casually make stock trades from their homes without fully appreciating how easy it is to lose money. The market is unforgiving to people who are not paying attention to what is happening on their computer screen. In fact, some people spend more time researching the purchase of a refrigerator than they do an investment.

There are some traders, including most pros, who have only one goal in mind, and that is to take money away from other traders. Even if you are an investor who makes an occasional trade or two, there is no reason why you should lose any of your hard-earned money. There are pros in the after-hours market who would like nothing better than to trade against undisciplined investors who aren't taking trading very seriously.

If you want to be a successful after-hours trader, you must only trade stocks when you are focused and alert. If you are distracted by what is going on in your house, it will be difficult for you to book profits. When you are a disciplined trader, you will only trade when you are mentally and physically prepared and concentrate on the business of making money.

STEP 5: LEARN HOW TO LOSE

As we wrote at the beginning of this chapter, before you learn how to win, you must learn how to lose. Losses are part of the trading game, and the sooner you learn to accept this fact, the more profitable you will eventually become. If you study the market, you learn that the most successful traders are not the ones who know how to pick winners, because anyone can do that, especially in a bull market. Rather, the successful traders have learned how to lose. We know it sounds strange to say you have to learn how to lose before you can win, but it's true. Many pros don't spend much time thinking of their winning stocks because winners tend to take care of themselves. It's the losers they're concerned about.

When you learn to lose in the stock market, you learn how to cut your losses, one of the hardest things for most traders to do. It is difficult for many people to admit they are wrong, that they made a mistake, and move to the next trade. No matter what the reason, too many people refuse to take a relatively small loss of a few hundred dollars. Instead they wait until the loss becomes so huge it begins to hurt. No wonder the pros characterize these traders as bleeders. By the time they realize they need help, their losses have bled their portfolio dry.

If you don't think you're going to lose money in the market, we promise that the market is going to teach you a lesson you will never forget. Even the most successful professionals lose money, but because they trade for a living, they know how to keep their losses to a minimum.

When you learn how to lose, it won't be difficult for you to sell a stock that goes against you. You don't care about the stock; it means nothing to you. Even if you are a long-term investor, some of your picks will not turn out the way you expected. As a long-term investor, perhaps you will give your stock picks a bit more time before you throw in the towel, but once you make the decision to sell, you should do it without hesitation.

Even the pros know they are going to be right only 7 out of 10 times, sometimes even less. When you buy a stock, you expect it to rise in value. Occasionally, even more than occasionally, you're going to be wrong. Instead of agonizing over your mistake,

you must be willing to cut your losses at 8, 9, or 10 percent or at a point where the monetary damage is minimal. If you look at the portfolios of profitable traders, first look at the size of their losses. The traders who have learned how to manage their losing stocks are the ones who will end up with the most profits.

If you are a disciplined trader, you won't take the loss personally. You know you can make it up with the next stock. It doesn't matter whether you are a short-term trader or long-term investor—when the stock you picked is not performing as you expected, you have to take action. Like a relationship that doesn't work out the way you expected, you need to get out of it—there is always another stock you can buy. Just chalk up a failed stock pick to a learning experience. Spend the time to analyze what went wrong and the mistakes that were made. Then try not to make them again.

In the end, the best advice comes from Ann Landers, who was talking about a failed relationship but could have been talking about the market. Her timely advice: Say good-bye and move on. And that's exactly what you should do when you are forced to sell a stock for a loss.

STEP 6: BE SELECTIVE ABOUT WHAT YOU BUY

The best traders are very selective about the trades they make, picking their trading opportunities with care. This is essential in the after-hours market, where there are opportunities as well as pitfalls, and it's sometimes hard to tell the difference. We have learned that the quality of your trades is more important than the quantity. That's right. You should spend more time analyzing the right trading opportunities than trading. It doesn't matter if you are an investor or a trader; you should be picky about the trades you make. Look at everything, but chase only a few. That is one of the secrets to making money in the market.

Many people are under the misconception that the only way to make money in the market is to make a lot of trades—an affliction some have jokingly called "marketitis." With this disease, you get addicted to the emotional excitement of the trading action without regard to how much money you make or lose. Like compulsive gamblers, you get your pleasure from the

act of trading. The end result is usually the same: loss of trading capital.

Even people who characterize themselves as long-term investors are often guilty of overtrading. In a well-publicized study by University of California at Davis professors Terrance Odean and Brad Barber, "The Common Stock Investment Performance of Individual Investors" (1999), they found that contrary to popular opinion, overtrading is hazardous to your wealth. In other words, the more you trade, the more likely it is you will lose money. Instead of giving their investments time to work, many people flit in and out of the market without a clear idea of the best time to buy or sell. If you are the type of trader who buys anything that moves, you are depending more on instinct and luck than on skill.

Perhaps you've heard the statistics on "scalping," that is, the daily buying and selling of hundreds of stocks for small 1⁄16 and 1⁄8 profits. More than 90 percent of intraday traders lose money, especially when they are first starting out. When the media talk about day trading, they are usually referring to the strategy of buying and selling lots of stocks for teeny profits. To be fair, if you are one of the few who are successful intraday traders, those little 1⁄8s and 1⁄16s can add up to six-figure winnings by the end of the year.

Most people, however, are advised to be selective about the stocks they pick. Like a cheetah waiting to pounce or a ninja preparing to fight, selective traders patiently wait for the right moment before they make their move. They spend more time analyzing trading opportunities than acting on them. This is the sign of a disciplined professional.

In the introduction, we described the after-hours market as a typically boring place punctuated by short and intense action. On many days we have found that trading after hours isn't very productive. Perhaps it's the low volume or the lack of significant news, but on many days, it's best not to force a trade.

Many people have found they are most profitable when they trade the least. Some of the best traders we know are out of the market more than they are in it, especially in the after-hours market. You should use this extra time to study and analyze the best trading opportunities. Trade hard and trade well, but only when the market is right.

If you are a short-term trader, you will base your stock selections on technical data such as volume or support and resistance levels. If you are an investor, you buy based on fundamental data such as earnings growth, return on equity, and the way the company is being managed. No matter whether you are a short-term trader or long-term investor, you only buy when there is a greater than 75 percent chance the stock will meet your criteria. This puts the odds in your favor. If the stock doesn't meet your criteria, find another stock to buy.

An effective way to increase profits is to only include a small but concentrated number of stocks in your portfolio. We believe it sometimes makes sense to include only the stocks that fit within your guidelines. For example, in the after-hours market, you might pick stocks in companies that are the industry or sector leaders, or companies that are growing more than their competition or exceed earnings expectations. We always ask why people buy the weakest companies in a particular sector when they can buy recognizable companies with proven earnings records. It makes more sense to buy stocks that are strongest and have the highest potential for success. This means limiting the number of stocks you follow or buy. The only downside of this strategy is that by limiting the number of stocks you buy, your portfolio will be less diversified, which goes against one of the main rules of financial planning.

On one hand, you should have a diversified portfolio of stocks, cash, and bonds. On the other hand, you can substantially increase your profits by holding a small number of securities. Nearly everyone agrees you should not allocate your entire account into only one or two positions. One solution, we believe, is keeping approximately half of your portfolio in index funds, mutual funds, or the stocks of well-established companies. Then use the amount remaining in your portfolio for short-term trading. In the next section, we will describe this strategy in more detail.

THE KNOWLEDGEABLE TRADER

As you know by now, discipline is a key ingredient in determining your success or failure as a trader. But even if you had all the

discipline in the world, you still need to make it your business to learn everything you can about the stock market, especially the after-hours market. Those with the most knowledge and discipline make the most money.

As an after-hours trader, it is essential you learn about the peculiar features of this market. Of course, our book is a good start, but it is only a beginning. You can get help by reading the major financial magazines like *Bloomberg, Business Week, Individual Investor, Online Investor, Kiplinger's, Money, Your Money,* and *Smart Money.* In addition, pick up a copy of the two major financial newspapers, *Investor's Business Daily* and the *Wall Street Journal,* as well as the weekly financial periodical, *Barron's.* You will eventually learn which publications best fit your trading style.

As we've mentioned before, the financial television network CNBC is a fixture in millions of homes and businesses. The *Bloomberg Moneycast* and CNN are also devoting time to the after-hours market. The financial television stations primarily look at the activity on Instinet, which is essentially geared to institutional investors, as well as Island, which generally caters to individual investors. You can get important clues about which stocks are most active during the after-hours market.

A helpful but potentially costly way of gaining knowledge is to take an investment course or seminar. There are hundreds of seminars catering to every type of online trader. As after-hours trading becomes more popular, look for seminars and courses geared specifically to the after-hours trader.

The best time to learn about the after-hours market is *before* you make your first trade. If you trade first and learn later, you will end up like thousands of others who lose money the first time they traded. We want to make sure you don't lose money unnecessarily while you are still learning. That is why it is so important to get your feet wet before venturing out into this brave new market.

If you are doing short-term trades, you will research the technical indicators of various stocks such as volume, trends, support and resistance, and moving averages. Make a list of the stocks that meet your requirements for the next day's trading session. This will give you a head start. If you are a long-term investor, look at the fundamentals of a company, such as earnings, company management, and the balance sheet.

One productive exercise is to study the limit order book to see how different stocks act. You can learn an incredible amount of information just by watching how various stocks trade. Look for the size of the spreads, trend reversals, and shifts in momentum or volume. One of our favorite web sites, besides the excellent ones we've previously mentioned, is finance.yahoo.com. It provides much of the data you need in one place, and also allows you to set up a personal portfolio to track different stocks.

Knowledgeable traders never stop learning about the market. The after-hours market is new, and it is guaranteed to be exciting, especially as we move toward a 24-hour global stock market. Arm yourself with knowledge and discipline and there is no limit to the amount of money you can make for yourself. You can begin by following these steps.

STEP 1: STUDY ALL THE STRATEGIES

If you want to make money in the stock market, take trading as seriously as the people who trade for a living. Act like the pros and come up with an investment strategy that reflects your personality and risk tolerance. A strategy will help you to determine if you want to be a long-term investor, a short-term trader, or a combination of the two. Most important, you should know in advance the strategy you will use when investing or trading in the market. The market is unforgiving to novice investors or traders who make the mistake of playing the market by ear.

If you are a long-term investor, you will generally hold your stocks for long periods of time, typically more than 12 months. As an investor, you can choose between a number of investment styles, including growth, value, contrarian, or any number of Dow dividend strategies. It takes time to learn which investment style you're most comfortable with. Fortunately, there are a ton of excellent books on the market that will help you determine which long-term strategy might be the most profitable for you. Since you will likely be a buy-and-hold investor, you can place your trades during the day or at night, whenever it is most convenient for you. You can also use the after-hours session to study the movements of the stocks you are most interested in.

The short-term trader ranges from an intraday trader to a swing trader, that is, someone who holds a stock for 1 to 5 days, perhaps even a couple of weeks. Many people don't realize there are as many short-term strategies as long-term strategies. Although many after-hours traders tend to be short-term traders, you can use many of the strategies in this book to improve your long-term returns as well. Finally, as we discussed in Chapter 5, you can become a long-term day trader, which allows you to combine long-term and short-term strategies within one portfolio.

It doesn't matter which strategy you ultimately choose as long as it makes sense to you. A strategy also forces you to focus on only those stocks that fit your criteria. With a strategy, the universe of stocks you will look at will be much more manageable, and perhaps more profitable. As an after-hours trader, you will only focus on the stocks that are available for trading after 4:00 p.m. EST.

This could mean trading only the 10 most active stocks listed on the ECNs. Turn to CNBC after 4:00 p.m. to find out which stocks are in play on Instinet or Island ECN, or REDIBook. By buying the most active stocks, you avoid taking a position in a thinly traded, illiquid stock. If you are a short-term after-hours trader, this strategy will allow you to quickly get in and out of a stock for, it is hoped, a profit. If you are a new trader, stick with the stocks of companies with medium or large capitalization, at least until you gain more experience. For a closer look at advanced after-hours trading strategies, turn to Chapter 9.

STEP 2: HAVE A GAME PLAN

Although it is essential that you have a trading strategy and the discipline to follow your strategy, most winning traders claim that having a game plan is equally important. Without a game plan, you won't have any idea where you're headed or if you've even arrived. You wouldn't start a business unless you had a plan. It's the same when you trade stocks.

A game plan is simply a list of the rules, goals, and trading strategies you will use to make money in the market. It could include the sectors of the market you think will be hot, specific stocks you want to watch, and decisions about whether you will

go long or short. It is your estimate of where to find the most successful moneymaking opportunities.

A game plan for the after-hours market might include stocks that are finishing the regular session strong or weak, companies that are announcing earnings or important news, and the sectors that were strong during the day. Very often, strong sectors or stocks will continue right into the after-hours market. You might also have a game plan for the first two hours, from 4:00 p.m. until 6:00 p.m., and another plan for the rest of the night.

It could be a mental plan or one written on paper, although novice traders should get into the habit of writing it on paper. Writing it internalizes it, making it easier for you to remember. It can also help you to control anxiety. A short-term trader will probably need a daily plan, but long-term investors can get by with a weekly or monthly plan. A game plan is important because it helps to keep you organized and on track. Without a game plan, you might rely on instincts and emotion, two characteristics that could hurt your portfolio.

A game plan also has to be flexible. In the morning, you may plan to buy 100 shares of Ericsson Telephone (ERICY) if it drops to $20 a share, but if the market doesn't cooperate, you need to have an alternative plan. Just because you created a brilliant game plan doesn't mean it will turn out that way, especially in the after-hours market, where anything can happen at night.

STEP 3: LEARN HOW INDIVIDUAL STOCKS BEHAVE

When you gain more experience in the after-hours market, you will get to know the personalities of certain stocks. It may sound funny to think that stocks have personalities, but they do. And once you become aware of the personalities of the stocks that you trade, you become sensitive to a change in personality. If a stock you are familiar with is not acting right, you can take immediate steps to protect yourself. For example, if the stock normally trades 10,000 shares a night and suddenly 1 million shares are traded, it could be a clue that a major institutional investor is selling off.

Some traders specialize in only one or two stocks. They not only learn everything about the company (long-term investors)

but also study the technical indicators (short-term traders) like support and resistance levels. You can pick up certain nuances about a stock that the average investor would never detect. Short-term traders are especially adept at using technical analysis to determine what price level to buy or sell at.

Some traders focus on a limited number of stocks in a certain sector. One effective strategy is to buy only the market leaders in each sector, the companies with the strongest growth and price performance. You can find these stocks with a relative price strength of 80 or higher by reading *Investor's Business Daily.* The *Wall Street Journal* also shows companies that are the market leaders in each sector.

When you study individual stocks, you will learn the number of shares that are usually traded each night, the price range, and certain technical factors like support and resistance levels. If you are a long-term investor, you will learn who manages the company, analyze the balance sheet, and look at actual and projected earnings. By becoming an expert on individual stocks, you will have a much better idea whether a stock you want to buy is a great deal or ridiculously overvalued. If you followed our advice about keeping a journal, you can write detailed information about what you have learned about each stock. After a while, you will know as much about individual stocks as you do about the people in your family.

STEP 4: LEARN HOW TO NEGOTIATE

It doesn't matter whether you want to buy a new car, ask for a raise, or trade stocks—the best negotiators are going to end up with the most money and the best deals. The after-hours market is a negotiated market. It is like a huge auction, something like an eBay for the stock market, where buyers and sellers meet and match offers. For example, when you place a limit order to buy a stock, you are negotiating with an unknown seller for the price you specify in your limit order. If you set the price too high, you may end up with the stock but at a less-than-desirable price. If you set the price of the stock too low, your order might never get filled.

An advantage you have with after-hours trading is that the ECNs make their limit order books available online, so you know

what the best bid and ask price is. Some ECNs, notably Island ECN, even show the "depth" of the after-hours market, that is, how many limit orders are waiting to be filled and the limit price of each order. With this information, you are in a stronger position to choose the best price. It is very frustrating to trade stocks in a negotiated market when one side, the professional trader, has more information than the other side, which is exactly what happens during the regular market day. This is likely to change, however, as retail investors demand access to the same information as the pros. It is also likely that more ECNs, if not all, will one day show the depth of the limit order book.

A good negotiator decides on a price and sticks to it. If you are a buyer, choose a price that favors you, perhaps at or lower than the bid. That's right. Buy the stock at the bid price. There is always the chance that you won't get filled, especially in a fast-moving market; but if you are a good negotiator, you know you can always find a better deal. If you are patient, the sellers will eventually come to you. One of the biggest mistakes you can make in an auction is to want a stock so badly that you have to chase it. Usually, if you ever do catch up with it, you end up buying it at its all-time high. If you want the stock that badly, then put in a limit order at the current or even a higher bid price. It will probably be matched quickly. We have used this strategy quite successfully during the after-hours market, scooping up momentum stocks that are on the move.

Although the after-hours market does not yet allow market orders, we must remind you that market orders are the same as paying the full sticker price on a new car. You are not negotiating when you place a market order. Perhaps there are times when you want to buy a stock so badly or sell it so quickly you don't care what price it is. That could be a warning sign. The pros who ultimately receive your order love market orders, because you're saying you are willing to pay any price for a stock.

STEP 5: CREATE A PRACTICE PORTFOLIO

If you are serious about trading in the after-hours market, we recommend that you create a practice portfolio before placing your first trade. It would be financial suicide to enter the after-hours

market without first learning how it works. Creating a practice portfolio will give you a chance to place practice trades, become familiar with the limit order book, and learn the nuances of your online broker and ECN. It will also give you the opportunity to test your trading skills before you commit your money to the market.

When you practice making trades with a play portfolio, you will learn that the stocks in the after-hours market trade differently than during the regular market. We cannot stress enough how important it is to make practice trades before you make your first real trade. The practice portfolio will help you to increase your skills as a trader and help you to trade without emotion, a key ingredient for successful traders.

Many traders complain that they seem to make tons of money in their practice portfolio but can't seem to duplicate their success in real life. The reason for this is simple: When you are only practicing trading, you are not emotionally involved in the transaction. Although this is one of the drawbacks to practice trading, the benefits far outweigh the disadvantages.

As we mentioned in Chapter 4, another way to test your skills and have fun at the same time is to join an Internet stock simulation game. Not only do you get a chance to win prizes, but you get to rate yourself against thousands of other traders. For example, eighth graders at Henderson School in Boca Raton, Florida, have been learning about the stock market for years with a simulated game called the Stock Market Game. Another choice for students is to join the CNBC Student Stock Market and compete against some of the top student traders in the country. No matter how you choose to participate, practice trading helps develop and refine your trading skills.

STEP 6: WATCH TELEVISION

We never thought we'd encourage you to watch television, but financial television networks and programs have made tremendous improvements over the years, especially CNBC and CNNfn. In particular, CNBC not only tips you off to late-breaking news but also reveals the most active after-hours stocks in a segment called "Extended Hours Trading." This can turn into huge profits

as other short-term players jump on the positive or negative news momentum. Because so many institutional and retail traders are tuned into this program, even the casual mention of a stock can immediately double or triple the volume.

The financial anchors regularly report on the after-hours trading activity on Island and Instinet, the two largest ECNs. When breaking news comes out around 4:00 p.m., knowledgeable traders can take advantage of it. If you're the type of trader that profits from late-breaking news announcements, CNBC will be your new best after-hours friend. Other financial news programs include CNNfn, *Bloomberg Moneycast,* and *Fox Business News.*

When the regular market is winding down, around 3:30 p.m., turn on the television. We know traders who specialize in late-afternoon stock plays. The last 15 minutes of the market are especially volatile, and the momentum can carry right into the after-hours market.

STEP 7: SHARE YOUR KNOWLEDGE WITH YOUR CHILDREN

The after-hours market is an ideal time to teach your children what you know about investments and savings. It is hard to imagine a greater gift to your children than passing on the tools and knowledge to generate wealth for themselves. Use the after-hours time period to show your children how the stock market works.

If you make it into a game, your children will pay attention. Take a portion of their allowance and teach them how to invest it in an individual stock or a mutual fund. The secret, as author Robert Kiyosaki once said, is to learn how to make money work for you rather than work for your money. This is just one of the lessons you can teach your children about the market.

Show your children how you can dollar-cost-average into the market every month to help them learn the importance of disciplined investing. No matter what the market is doing each day, invest a set amount into the market every month. This will teach your children the most important rule of money management, to pay yourself first.

Bring up the limit order book on one of the ECNs and show your children how people are bidding for stocks, just like you would do in an auction or on eBay. You can explain the difference between a bid and ask price and the importance of negotiation. Using the stock market as your classroom, you can teach them how to be a good negotiator, a skill that is required in the twenty-first century. Perhaps they won't immediately see the value of algebra or geometry, but negotiating for the best prices will make sense to them.

Be sure you let them know that the stock symbols represent real companies like Disney (DIS), McDonald's (MCD), and Toys-'R'-Us (TOY). If you stress the fun part of the market (competing with others for the best price) and gloss over the boring parts (analyzing profit and loss statements), your children might want to participate. Learning about the stock market might help your children in ways you could never imagine. Take advantage of the late market hours to give them an education on investing they will remember for a lifetime.

THE CONSERVATIVE TRADER

It may seem like an oxymoron, but we think it is possible for you to minimize risk while aggressively trading stocks. If you are a risk-averse, conservative trader, you are looking for profitable opportunities in the market without taking unnecessary chances. There are many people who think that investing directly in the stock market is too risky for the average investor. We think that risk is the price you pay for the chance to increase your profits. The goal, therefore, is to maximize profits while minimizing risks.

Speaking of risk, there are three types of risk you take when trading after-hours. First, there is always the chance you will lose money in the market because of short-term drops or because of a bear market. This is part of being in the market, and there is nothing you can do about it. Investment risk, on the other hand, is the chance you will lose money on individual stocks because of poor stock selection or a failure to properly manage your

money. Finally, there is risk associated with being in the after-hours market such as the lack of liquidity, wild price swings, and fragmentation. Although there are specific strategies to minimize all three risks, there is no way to eliminate them completely. If you are a conservative trader, any form of risk might make you feel nervous.

We strongly believe you should never participate in something that makes you nervous or anxious. Although we mentioned it before, an effective way of participating in the market without experiencing too much emotional pain is to stick with professionally managed mutual funds or index funds. If you invest in a mutual fund or index fund, you probably won't panic when the market drops by hundreds of points in a single day. The other advantage is that you have someone else to blame if you lose money.

Letting a professional manage your account makes sense for a lot of people, especially if you don't have time to monitor your investments. Although the after-hours market allows you to buy stocks after you get home from work, you might still be too busy to give it your full attention. It is better to let the investment professional do all the work so you can go home and relax. If you change your mind in the future, the after-hours market will still be there.

Be aware that there are steps you can take to minimize your risk.

STEP 1: DON'T AVERAGE DOWN

A controversial trading strategy used by some pros is averaging down, or buying more shares of a stock while it is falling in price. It is controversial because if you are right and the stock turns around, you can make a small fortune. If, however, the stock remains in the doldrums, at best, you have wasted a lot of money on a stock that is going nowhere.

A good example of averaging down occurred in the fall of 1999, when shares of Waste Management (WMI) fell from $60 a share to as low as $14. News was just released that the company was experiencing auditing problems and had to take a nearly billion-dollar charge against third-quarter earnings. While the

stock was falling, a number of professional institutional investors studied the balance sheets and met with management, concluding the internal problems were only temporary. As a result, a number of pros averaged down, or bought shares of the stock as it continued to plummet. It will probably be years before we learn if the pros were right and that averaging down worked on this stock.

Another problem with averaging down is that you are tying up trading capital on stocks that might take years to recover. Unless you know more about the company than Wall Street does, or you're a professional fund manager, pouring new money into falling stocks can be an extremely risky strategy. The problem with averaging down is that it sometimes takes a while before the bottom is reached. Meanwhile, as the stock keeps falling, you keep losing money. The pros refer to it as trying to catch a falling knife. You'll probably cut yourself if you try and catch the knife as it's falling. It is safer to wait until it hits the floor before you pick it up.

On the other hand, it is true that well-informed investors, who know, for example, the private market value of a company, could make a lot of money by averaging down. We know a number of value investors who made small fortunes by averaging down because they knew more about the company or the industry than everyone else did. One of the reasons the stock market is so fascinating is there are exceptions to nearly every rule, including averaging down.

If you are attracted to a strategy of buying out-of-favor, beaten-down stocks, wait until all the bad news is out and the stock has hit bottom before buying more shares. Unless you are going to short the stock, it is suggested you stay out of the way of falling stocks. Although a good technical analyst can often determine when a stock has hit a temporary bottom, what is called a "support level," when news is affecting the stock, no one can predict how low the stock might go.

STEP 2: START SLOWLY

By the time you finish reading this book, you may be eager to open an online account and immediately start trading stocks at

night. Before you place your first trade, however, we suggest you start small, perhaps with less than a few thousand dollars. You can often start trading with as little as a thousand dollars, depending on the broker you choose. Why not learn the ins and outs of the after-hours market with as little money as possible. If you turn that $1,000 into $2,000 by the end of the year, a 100 percent return, you just might have what it takes to be a profitable trader. Trading with a small amount of money is similar to using a practice portfolio except you are using real money.

You don't have to start with a year's salary to make money in the market. We know a woman in California who started with $5,000 and day-traded her way to a $250,000 portfolio in less than 1 year. When you're trying something new, like after-hours trading, first dip your toe in before you jump in with your whole body. When you can make a lot of money with a little money, it will build your confidence and give you tangible evidence that you have what it takes to be profitable. Conservative traders don't take unnecessary risks with money they can't afford to lose.

STEP 3: PROTECT GAINS

For the short-term portion of your portfolio, which will likely include after-hours trading, you might buy and sell rapidly. For this reason, it is important that you have a selling strategy that closely reflects your style of investing. If you buy a stock based on the news that a company had spectacular earnings and the stock rises in the after-hours market, you have to decide whether to buy and hold or to sell quickly.

If you are a short-term trader, you hope to sell your shares for a quick profit. If you are a long-term investor, you'll hold everything and then go to sleep. If you use long-term day trading strategies, which we explained earlier, you might sell half your shares for a short-term gain but keep a portion for the long-term part of your portfolio. If you're on the conservative side, a bird in the hand is worth two in the bush, so think about selling half your shares, especially if you have substantial profits. The most important lesson, one you must never forget, is to never let your profits turn into losses. Taking home profits is good for your ego as well as your bank account.

STEP 4: USE MARGIN WISELY

Margin is another one of those controversial tactics that few people agree on. If you are disciplined and practice sound money management techniques, then borrowing from the brokerage to increase your trading capital will probably help you. When you go on margin, you can borrow up to 100 percent of the securities in your account. For example, if you own $10,000 worth of stock, you can borrow an additional $10,000 from the brokerage to buy more stocks.

Many short-term traders, and that includes night traders, use margin to substantially increase their buying power. With this strategy, you would go flat at the end of the night, that is, sell all your stock positions. This is how many day traders minimize risk. They will never take the chance their stocks could fall in the middle of the night or during the premarket.

If you are a conservative trader, it is probably best to avoid going on margin, especially when you are first beginning. With margin, you are substantially increasing your risk to boost your profits. Although it is a profitable strategy if you have strict money management habits, until you gain more experience in the markets, it is best to avoid it. It's like shopping with an unlimited line of credit. After a while, you begin to lose track of how much you made or lost until the bill comes at the end of the month. In the case of margin, if you are in the red, you could get a call from the brokerage demanding that you pay the money you owe.

THE SELF-CONFIDENT TRADER

It takes more than a successful strategy, knowledge, and discipline to make it in the market. Like anything else you do in life, you also need to believe that one day you will be successful. When you believe in what you are trying to accomplish, you will let nothing get in the way of your goals. It is difficult to teach but more valuable than gold. After all, money comes and goes, but a winning attitude and self-confidence last a lifetime.

We have found that the most profitable traders have an inordinate amount of faith in themselves. Mark Cook, an extremely successful intraday trader, initially lost money in the market every year for 5 years before becoming a multimillionaire success story. Although his yearly losses were extremely difficult, his will and determination sustained him through 5 years of rejection and criticism. It took a long time before he was able to prove that his strategies and tactics worked.

It also takes courage. If the market is falling by hundreds of points and dozens of experts go on the air to proclaim the bull market is dead, the self-confident trader doesn't abandon his or her strategies and rules based on the results of a 1-day panic. It takes more than a few short-term drops in the market to unnerve self-confident traders. When you truly believe in what you are doing, you'll have the strength and patience to withstand nearly every obstacle. The best traders get beaten up, but they don't get beat. They are obsessively determined to be profitable, and nothing will get in their way until they have achieved their goals.

No matter what you do in life, there will always be people who will do everything in their power to convince you to abandon your dreams. It is easy to come up with reasons why something can't be done. Try to avoid traders with self-defeating attitudes who wouldn't know what to do with a winning strategy even if it was handed to them. If there is anything that can ruin your investment portfolio, and perhaps your life, it is associating with negative, critical people who get pleasure out of seeing you fail.

It's the same with after-hours trading. It's easy to come up with reasons why you shouldn't participate. The real challenge is having the courage and trust to try something new. This is easier said than done, especially if you initially lose money. There is no doubt that if you trade stocks at night, to be successful, you need self-confidence. Here are some steps to building your self-confidence.

STEP 1: LOOK AT THE BIGGER PICTURE

It's not easy to see the bigger picture when all your investments are losing money and the market looks like it is going to the dogs.

These are the times that separate the winners from the losers. The winning traders step back and see what the market will look like in 6 months or a year or even 5 years. If you can keep your head about you while others are losing theirs (to borrow from Rudyard Kipling), not only will you become a better trader, but when the market does turn around, you will be the first to see moneymaking opportunities when they do appear. To use an analogy, while others are in the forest trying to avoid walking into trees, you step back and see the whole forest. One of the characteristics of a winning, self-confident trader is to not get distracted by the small details in life but keep your eye on the bigger picture.

We're sure that Y2K could have been quite uncomfortable for millions of companies if steps hadn't been taken to upgrade their computer systems. However, those investors who ignored the doomsday predictions of some very knowledgeable experts made more money at the end of 1999 than during the whole year. It took tremendous courage to ignore the Y2K hype and see that the world wasn't going to end because of a programming error.

In this case, it was easier to believe the Y2K propaganda than to objectively look at the facts. To the credit of many mutual fund managers and millions of online investors, instead of selling their stocks, they kept buying. They weren't going to let one little date change interrupt their long-term investment strategies.

With the after-hours market, try to ignore the unsubstantiated hysteria from those who want to scare you away from a potentially profitable opportunity. As long as you take steps to minimize risk and know what you are doing, you will see that after-hours trading is just one small step to a fully electronic, 24-hour-a-day global market. Now that is the bigger picture.

STEP 2: LOOK FOR OPPORTUNITIES

Because after-hours trading is so new, many will be afraid to try it. A few years ago, we spoke with a couple of high-level insurance executives who were unwilling to put their company on the Internet for their customers or employees. They saw the Internet as little more than an online toy that would disappear by the following Christmas. "The more I use the Internet," one top-level vice president told us, "the more I am convinced it has no place

in our company." As you can guess, this particular company had to spend the next 2 years playing catch-up with the competition.

It is true that a lot of intelligent people were wrong about the Internet. It will be the same with the after-hours market. Some will see it as a threat to the way that they've been doing business. Others will see it as an opportunity to increase profits and make trading more convenient.

You have to be particularly observant to see moneymaking opportunities. As Wall Street changes and reinvents itself, those with insight and courage will always see financial opportunities. As the 24-hour trading day becomes more popular and as people from around the world tap into our stock market via the Internet, there will be tremendous opportunities to increase your wealth. The after-hours market will be there when the rest of the world is ready to participate. Meanwhile, never stop looking for ways to increase your income and improve your life.

You need more than a positive attitude to make a fortune in the market. While some traders see potential problems and conflicts, the most profitable traders see opportunities. Take these opportunities and use them to reach your financial goals.

One effective technique employed by dozens of professional athletes is to close your eyes. That's right, close your eyes and visualize yourself in profitable trades. Perhaps this won't make all your wishes come true, but it could do wonders for your attitude, an essential ingredient for winning traders. A positive attitude is essential no matter what you do in life, including after-hours trading. It takes an incredible amount of faith to believe that everything will work out in the end, even when there is no evidence it will. There are a number of useful exercises that will help you to visualize success. The bottom line is, you are what you think you are. Imagine yourself as a winner and you are at least halfway there.

One way to increase your self-confidence is to take home profits. If you are a short-term trader, you want to frequently book profits, even if it is for small amounts. If you are a long-term investor, you want to see paper profits. Success leads to more success.

By reading this book, you have proved you are at least willing to look at new investment or trading opportunities. It takes a

lot of courage to be first, but we think the rewards will make your efforts worthwhile. At first, there could be resistance from other people because after-hours trading is so different. Eventually, just like ATM machines and 7-Elevens, people will wonder how they ever lived without it.

STEP 3: JUST DO IT!

Hemingway once joked that those who can, do, and those who can't, teach. Although Hemingway was trying to be funny, in reality, he was wrong. People in every occupation, including teachers, have the intelligence and skill to be tremendously successful. Yet many choose to play it a bit too safe, afraid to take chances to pursue their dreams.

If you have dreamed of being a trader, the after-hours market is an excellent opportunity for you to test your skills without interfering with your full-time job. It doesn't matter if you want to be a professional trader, a corporate trainer, or an architect. Do whatever it takes to get what you want out of life. When you do something you love, you'll never work a day in your life. As one of our friends used to say, repeating a cliché she once heard on a television commercial: Just do it!

READ THIS FIRST

By now, you probably share our enthusiasm for after-hours trading and are eager to get started. Before you make your first trade, however, we strongly recommend that you thoroughly read the next chapter, where we discuss the unique risks of extended-hours trading. Understanding the risks will help you avoid many of the pitfalls that doom less experienced traders and investors.

7

THE RISKS OF AFTER-HOURS TRADING

If there is one certainty about the stock market, it is that there is always the risk you could lose money on your investments. The sooner you accept the idea that losing money is an inevitable fact of participating in the market, the more likely you'll take steps to limit how much you lose. Therefore, the key to becoming a successful trader is your ability to manage risk. If you can control your losses and generate consistent results, you will do very well.

We have already written about the difference between market risk and investment risk. Briefly, when you invest in the stock market, there are three ways you could lose money. The first is what we call market risk—the entire stock market could experience a short-term drop in value or a lengthy bear market, causing your investments to lose value. There is no way to avoid market risk, and few people can consistently predict when these short-term drops will occur.

We've been fortunate that the market has been steadily trending upward for so many years, but there is little reason to believe it will continue to be so spectacular. Although the market has generally gone up in value for the last 60 years, there are no guarantees. When you put money in the market, you also have to

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accept the fact that the market might go down and you could lose money.

On the other hand, you do take responsibility for and can control what we call investment risk. When you trade stocks, you have the freedom to choose which stocks you want to buy or sell. Unlike with mutual funds, you are not locked into any single sector or market capitalization. With each trade, you must make a decision when to buy or when to sell. If you make mistakes or pick inferior stocks, you will lose money. This is the risk that you take when you participate in the market, and you are completely responsible for how much money you make or lose. The good news is there are steps to minimize investment risks, which we described more fully in Chapter 6. In fact, as you learned from reading that chapter, most people lose money in the market not because the market did anything wrong, but because they are not following sound money management procedures.

You also subject yourself to additional risks by trading in the after-hours market. We wish we could tell you that trading in this market is remarkably similar to trading during the day, but we can't, because it's not true. In fact, trading after hours involves a unique set of risks unlike anything you have ever experienced. The good news, however, is that if you are able to make money in the after-hours market, you can apply those techniques to successfully trade in other markets. The after-hours market is more difficult than regular hours, mostly because of liquidity. If you do master the nuances and intricacies of the after-hours market, however, you're probably going to evolve into a superb trader. The best news of all is that many of the risks associated with the after-hours market will diminish over time as more people participate in the extended-hours sessions, which is already starting to happen.

Those who are most against after-hours trading, and there are quite a few critics, will warn you of the absolutely worst after-hours scenario, the kind of nightmare we wouldn't wish on any trader. Perhaps this is how it was in the early days before the NYSE and Nasdaq stocks were traded, before the liquidity improved, and before the major market participants joined together to bring you a centralized market. It really was like the Wild West at one time, and anyone who ventured into it could easily

become lost and confused. Although the after-hours market is nowhere near as dangerous to your wealth as, for example, the Chicago futures exchange, if you aren't prepared, you could get hurt, especially if you are trading for the first time.

Only you can decide if the after-hours market is a convenient opportunity to increase your income or a wild and unknown entity that is best left to professional traders. Critics say if you want to do after-hours trading, you should participate by letting professional fund managers trade for you through mutual funds, pension funds, and 401(k) plans. Keep in mind, however, that as more people flock to after-hours trading, many of the risks outlined in this chapter will be minimized, and in some cases, eliminated. Eventually, the after-hours market will simply become an extension of the regular market.

The purpose of this chapter is to make you aware of all the potential risks and pitfalls associated with after-hours trading, and to provide you with suggestions on how to avoid them. After weighing the potential risks against the possible rewards, you can objectively decide if you'd be comfortable as an after-hours trader. With that in mind, let's take a close look at the risks and pitfalls of after-hours trading.

LACK OF LIQUIDITY

When the after-hours market was first introduced, all anyone could talk about was the lack of liquidity. This simply means there weren't enough buyers or sellers participating in the market. For many stocks there were no competitive bid or ask prices. Even if you wanted to sell your stock, there was no one on the other side to buy it from you. The problem still persists with a few thinly traded stocks. Without liquidity, you have a very volatile market with wild price swings.

It was understandable why retail investors initially stayed away from the after-hours market. First, there was a lot of negative press on the risks of trading stocks at night, equating it to a gambling casino and warning about the lack of liquidity. It was a classic catch-22 scenario. Buyers wouldn't show up because of

the lack of liquidity, but the liquidity couldn't improve until buyers showed up. Second, there wasn't a lot of information on after-hours trading, and very few people understood how it worked. Like any new market, it takes time for people to understand what is involved.

However, it was only a few months before people began to flock to the after-hours market, ignoring the expert advice. At first, Island reported less than 800,000 shares a night being traded after hours. This soon grew to 8 million shares a night, which doubled within a few months to 15 million shares being traded a night. Each month, the other ECNs reported a steady increase in after-hours volume. To repeat what we noted before, it won't be long before it will be hard to distinguish between the after-hours market and the regular market. It will simply become a continuation of the regular trading day.

The problem with illiquidity is it's easy for a professional trader or well-capitalized individual to manipulate a stock by buying tens of thousands of shares in a low-priced stock. This is also a problem in the regular market, but it is exaggerated after hours. For example, someone could buy 5,000 shares of a thinly traded $5 stock. Although 5,000 shares might not make a noticeable difference in the regular market, in the after-hours market the increased volume could cause a huge rise in the price. Conversely, if an individual with a large position in an illiquid stock decided to sell in the after-hours market, the price of the stock could dramatically fall.

To avoid getting caught on the wrong side of an illiquid after-hours stock, you should search out market-leading stocks with high nightly volume. That is why it is so important that you pay attention to the number of shares being traded on each stock. Use the limit order book or Internet research tools and study the technical and fundamental data for each stock. A number of ECNs publish the top most active stocks for the night. If you participate primarily in these stocks, you will avoid some of the problems associated with illiquid stocks.

Although liquidity was definitely a concern in the early days of after-hours trading, this risk was minimized when more people started showing up at night to trade stocks. In addition, the major market participants took steps to improve liquidity.

For instance, the ECNs signed a letter of agreement to physically connect their trading networks together so all the ECNs could match orders among themselves, increasing the pool of liquidity. This is just one of the steps the major market participants took to reduce an illiquid trading environment, although it is not possible to eliminate it completely. Another choice is to do your trading on the ECNs that have the most liquidity.

FRAGMENTATION

Another frequent complaint about the after-hours environment was that it was too fragmented. Critics complained that ECNs put their networks and software up too fast without even attempting to coordinate with other major market participants. The ECNs responded by telling the critics that by working as separate entities they are helping to increase competition, which is healthy for the stock market.

Why is fragmentation a problem for retail investors? When you have a bad case of fragmentation, which was evident in the early days, all the ECNs, exchanges, and stock markets display different prices, making it difficult for retail investors to be sure of the true price of a stock. You could place an order on one ECN, for example, MarketXT, and then find out on CNBC there is a better quote on Island. This results in a disjointed marketplace that confuses retail investors. They aren't sure if they are getting the best price for a security.

Sophisticated short-term traders took advantage of the extreme fragmentation by engaging in arbitrage, that is, buying on one ECN and selling on another, profiting from the price difference. If you look in Chapter 9, you will see a few of these advanced strategies. Even though the extreme price differences are slowly narrowing, there still could always be enough of a price spread between competing ECNs to allow sophisticated arbitrage players to make profits. In order to engage in arbitrage effectively, you need fast and cheap executions, and often there aren't enough shares to make this an effective strategy. Only you can decide if the effort you take is worth the profits you make.

Whether you think fragmentation is simply the beauty of competition or a disorganized, disjointed market, it's important to realize that all market participants have taken steps to coordinate their systems. The SEC stepped in by organizing a series of working groups designed to get all the major market participants to talk to each other. As a result of the group meetings, all the major players came up with a series of proposals designed to encourage everyone to follow the same set of rules.

Then the Nasdaq Stock Market extended its consolidated quote system, at first until 6:30 p.m. EST and eventually to 8:00 p.m. EST. Before the consolidated quote system was extended, you could easily get a half-dozen quotes on the same stock. Now there is a centralized quote system where everyone receives the quotes at the same time.

As the ECNs physically connect to each other and share order flow, if you place an order on one ECN, it will then go out to all the ECNs simultaneously, looking for an available match. To its credit, Archipelago was the first ECN that was designed to find a match among all other market participants. It first tried to match your order within its own system. If it couldn't find a match internally, it would route your order to other market participants, including ECNs, until a match was available.

The other good news for retail investors is that fragmentation is slowly being reduced, although as long as you have a stock market with competing exchanges, it will never go away completely. As all the market participants work together in the future, retail investors will finally get what they have been asking for for over 200 years: a transparent market where everyone has full and equal access to the market, quote information, and news. When everyone is reading quotes from the same centralized location, fragmentation in the after-hours market will no longer be a problem.

WILD PRICE SWINGS

The roller coaster effect of the stock market has doomed many traders over the years. When you combine a thinly traded stock with an illiquid market, you end up with extremely wild price

swings. Although these swings occur in both the regular market and the after-hours market, you have to be particularly careful in the after-hours market, especially after news is released. Although you could get a profitable ride if you are correct about the timing and the price of the stock, it can be risky.

For example, let's say you buy 400 shares of Intel Corporation (INTC) because it is attracting heavy institutional activity after beating first-call estimates by 2 cents. Perhaps it was also mentioned on CNBC as being active near the end of the day because the company reported its net income and margins rose. You think these blowout numbers will send the stock higher. Unbeknown to you, the institutions interpret the news differently than you expect. Remember that each company trades differently on news. For stocks like Intel, sometimes a conference call with company executives and the next-quarter outlook are more important than the actual numbers. As the conference call proceeds, the stock might trade wildly. Unless you are on the right side of the swing, you could lose money.

There are several questions you have to ask yourself when trading on earnings reports. First, what are the whisper numbers? Whisper numbers can best be described as the fine tuning of analyst earnings estimates. As the quarterly results are released by the company, the analyst will be able to more accurately estimate the numbers. Rather than repeatedly change the numbers in a report, an analyst may circulate whisper numbers to various institutions. You can attempt to guess the whisper numbers by watching CNBC or other financial television programs, but it's difficult unless you have direct access to the analysts. A web site devoted to analyzing analyst whisper numbers is www.whispernumber.com.

Wild price swings are even more profound when there is heavy buying or selling power in an after-hours stock that has mediocre activity. That is why it is essential to know which way the stock may go before you buy. The goal is to turn a price swing to your advantage by buying on momentum, the kind of strategy most short-term traders love. To be successful, you need to take the time to read and interpret breaking news correctly.

In the last couple of years, the Internet stocks have been the most volatile. It's important to move with the trend and avoid

staying around long after the party is over. Some past crazes have included: Linux, wireless, Pokemon, and ISPs. It is hard to predict which sectors will be in favor at any given time, but if you read the news accurately and act quickly, you can turn the risk of wild price swings into profitable opportunities.

Volatile stocks and erratic price movements are a good example of how you can either profit or perish in the market. A knowledgeable short-term trader can use the strategies included in this book to make huge profits from price swings. On the other hand, an uninformed investor could lose a small fortune. One of the secrets to making money in the market is to gain an edge over your opponents. The more knowledge and experience you have, the more of an edge you will have.

If you have the stomach and skill to profit from the wild price swings of volatile stocks, then trade them. If you're not comfortable with volatile stocks, stick with stable companies with predictable and steady earnings and small price moves. The NYSE stocks traditionally tend to be more predictable, although in the after-hours market, anything can happen.

WIDE PRICE SPREADS

One of the concerns about the after-hours market is that the spreads between the bid and ask (buy and sell) price would be higher than in the regular market. Higher spreads often cause retail investors to lose money. The higher the spread, the more apt you are to lose money. It is not uncommon to see high spreads, perhaps 1 or 2 points or more, on thinly traded, illiquid stocks that haven't attracted a huge amount of buying interest. For example, one night Concur Technologies (CNQR) had a spread of 26 by 27⅞, an almost 2-point difference between the bid and the ask price. If you bought Concur Technologies at 27⅞ and you immediately tried to sell it, the best price you could get was 26.

Although high spreads can and do occur in the regular session as well, tighter restrictions by the SEC have helped to keep the spreads narrow. As you might remember, the tighter restrictions were a result of a price-fixing scandal involving Nasdaq

market makers a few years ago. The market makers were accused of artificially keeping the spreads high by ignoring limit orders placed between the bid and ask price. The SEC created a set of rules to eliminate price fixing, and as a result, spreads on all stocks have narrowed since that time.

Even when the market makers and specialists eventually begin to participate in the after-hours session, you should expect to see higher spreads than during the regular market. After all, individual investors and traders set prices. Because you are depending on the buyers and sellers to set the prices, higher spreads will be more common.

As more investors and traders enter the after-hours arena, as the liquidity keeps improving, the competitive forces of the market will naturally narrow the spreads. Although increased competition won't solve all the problems, especially with low-priced, illiquid penny stocks, it will help to alleviate some.

If you are a short-term trader, you can turn the problem of high spreads into a profitable advantage. For example, if you emulate the market makers by buying on the bid and selling on the ask price, you can make small but steady profits. Although this strategy is easier said than done, it can be profitable. For those who are interested, we describe some of these sophisticated night-trading strategies in Chapter 9. But if you are an individual investor, it is probably wiser to place your limit order somewhere between the best bid and ask price. In time, your order will probably get filled at the price you specify.

In general, try to avoid trading stocks that have unusually high spreads (a point or more higher between the bid and ask price). If you are patient, the spreads could narrow, especially if you are willing to wait until the regular market session. Why should you buy a stock and already be 1 or 2 points behind? Before you let go of the mouse, you are already playing catch-up.

CASINO MENTALITY

A concern of the SEC and other government regulators is that people with compulsive gambling problems are going to be drawn to

the after-hours market, using it to place bets on stocks. Instead of playing craps in Las Vegas, they will try their luck with a roll of the Dow. As many people have learned, it is almost too easy to gamble on stocks with nothing more than a home computer.

In addition, some brokerage advertising has seduced people into thinking that a click of the mouse is all it takes to earn millions in the stock market. There is no doubt that thousands of people are already playing the stock market like a roulette wheel during the day. The lure of a 24-hour stock market with a chance to make money is too hard for some people to resist.

No matter how many regulations you pass, it is impossible to protect people from themselves. There are indications that compulsive gamblers have already discovered the stock market. The long-lasting bull market, the better-than-average odds, the excitement of making or losing a fortune, and the entire country's fascination with the market have drawn thousands of compulsive gamblers to the market. You can watch the action on CNBC any time of the day or night, placing your bets at home or on a wireless device like the Palm Pilot. Compulsive gamblers are already placing their bets during the day, and it is likely they will continue to play the markets at night.

The public's fascination with the stock market and the almost daily reports of people striking it rich have helped convince a lot of people that the market is a glorified casino. At least with the market, the odds are in your favor—although if you are a compulsive gambler, it doesn't matter, because the chances are you will probably gamble until you lose.

If you recognize that you're placing wild bets on stocks without a clear strategy or spending money you can't afford to lose, and if your losses are so excessive they are interfering in your life, then you must take immediate steps to stop. We are not qualified to give psychological advice, but if you think you are gambling in the market, you need to do yourself a favor and seek professional help. Our friend, Dr. John Schott, psychoanalyst and author of *Mind over Money,* has treated dozens of compulsive gamblers addicted to the stock market. He told us about one novice trader who took a $40,000 inheritance and quickly ran it up to $65,000. He thought he had found the goose with the golden egg. As often happens with these easy-come, easy-go stock stories, within days, he lost the entire $65,000 as well as an

additional $120,000. He stopped trading only when his family took legal action, threatening the brokerage to shut down his account. Once you cross the line from trading to gambling, as this man did, it is hard to go back.

Indeed, if you are gambling in the market rather than trading, it is probably only a matter of time before your account is completely wiped out. If you actually make money in the market in spite of your gambling addiction, you should walk away while you still have money in the bank. We know people who have made and lost millions in the market, and for reasons we still don't understand, never set aside a dime in a money market account or mutual fund. They used every available cent to trade. Frank Farley, a psychologist at Temple University in Philadelphia, identified these people as having "Type-T personalities"—thrill seekers. These are people willing to win or lose it all on one trade.

Although the after-hours market is not at fault, we do know that some people can't resist the lure of a 24-hour market. If you recognize that you or someone you know has crossed the line from trader to compulsive gambler, we encourage you to talk to a trained professional. Even winning traders have sought out trading psychiatrists to help them overcome many of the psychological pitfalls of trading stocks. The goal is to adopt the positive characteristics of successful traders while ridding yourself of any habits that will interfere with your ability to make money. If you routinely lose more money than you make in the market and you are not utilizing any risk management tactics, such as stop losses, you must take steps to protect yourself. In the opinion of some psychiatrists, we all have unconscious gambling tendencies. The difference is that the trades of a compulsive gambler will be erratic and unpredictable, and eventually will lead to losses. Another clue is that the trading begins to interfere in your personal and professional life.

NIGHT TRADING

Ever since a disgruntled day trader named Mark Barton gunned down a dozen traders at two Atlanta brokerage firms, the media have reported incessantly about the dangers of day trading. Many have characterized day traders as wild and reckless burn-

outs, making thousands of trades a year for the chance to scalp for 1⁄16 or 1⁄8 profits. We know from personal experience that this is a misconception, and an unfair generalization. Many of the most profitable day traders we know are quietly making consistent profits in the market from the comfort of their own home. You will never hear any news about them.

It is true that most pros agree that the strategy of quickly buying and selling stocks for small profits, or intraday trading, is difficult and time-consuming. This strategy is also called "trading the teenies" or scalping. Only a few traders have been successful at it, perhaps no more than 5 or 10 percent. It is extremely difficult to make profits during the day using this strategy and almost impossible at night. So far, most intraday traders have resisted using these strategies at night, primarily because there isn't enough liquidity. Unless you are one of the few who can consistently make money with intraday trading, you might want to stick with other short-term strategies.

The lack of liquidity and high spreads combine to make intranight trading extremely difficult. Most pros would be uncomfortable with intranight trading because they might have difficulty getting out of a position. If you have your heart set on being a scalper, you'd be better off practicing during the day before you trade stocks at night, at least until there is more liquidity.

The fear of the SEC and other government regulators is that a whole new class of traders are going to join the after-hours market to try night trading. Because of the SEC's concerns, the online brokers and ECNs took great pains to warn traders of all the possible pitfalls, perhaps scaring off even long-term investors. As long as you avoid using some of the riskiest strategies, like intranight trading, and concentrate on strategies that will give you the best chances for success, you have little to worry about. If you are knowledgeable, disciplined, and experienced, nothing should prevent you from making consistent profits in the market.

DUMB MISTAKES

Nothing is really more annoying when trading in the stock market than losing money to dumb mistakes, the kind that are so

easy to prevent. Every trader, including the pros, makes mistakes at one time or another. The sooner you realize that you will occasionally make mistakes, the quicker you will learn how to prevent them from happening. Of all the risks associated with after-hours trading, mistakes are the most common—but the easiest to control.

Although all the pros make mistakes, they have two advantages over retail investors. First, they are trading with OPM (other people's money), which helps to minimize the pain when they lose. Second, the pros have learned from experience how to minimize mistakes, mostly by avoiding the most common traps and pitfalls, including trading on tips, switching investment strategies, and buying the stocks of low-quality companies.

Many mistakes are simply the result of carelessness. For example, one night on CNBC, the financial reporters breathlessly reported that a stock, Juno Online Services (JWEB), was extremely active in after-hours trading, causing the stock to spike up past $30 a share. Immediately after this comment was made, we noticed that someone got the stock symbols mixed up. Instead of placing a limit order for $30 a share for JWEB, this person placed a limit order for Juno Lighting (JUNO). Unfortunately for this buyer, the highest ask price for JUNO was $9 a share, so this hapless individual placed an order to buy the stock for $21 more than the market thought it was worth. A savvy trader saw the mistaken $30 order and immediately matched it.

Fortunately for this person, all the brokerages have an "erroneous trade" policy that will reverse a trade if there is an obvious error, as there was in this case. One hopes that this person contacted the brokerage to have the trade rescinded. The ECNs work closely with the online brokerages to make sure their customers don't lose money to these kinds of mistakes.

It does prove, however, how easy it is to lose money if you are not careful about the trades you make. With experience, you will learn to keep mistakes to a minimum, just as the pros have learned to do. One suggestion is not to trade stocks while you are eating dinner or watching television. The less you concentrate on trading stocks, the greater the chance you will make errors. If you just got home after a stressful day of work and are too tired

to think straight, perhaps you can find something more relaxing to do than trading stocks that night.

LACK OF KNOWLEDGE

We have done everything we can to give you the knowledge you need in order to be a successful after-hours trader. Even after reading this book, however, you should continue to increase your skills by using the Internet, reading financial publications, and watching financial television programs. You are competing with thousands of other traders for buying and selling opportunities. To be a profitable after-hours trader, you also need a deeper understanding of how this unique market functions.

For example, our neighbor lost money on a premarket trade last year because he didn't understand how erratic the opening session of the stock market is. A stock called Concur Technologies (CNQR) had been attracting early buyer interest among short-term traders. It was rising rapidly minutes before the opening bell of the NYSE. Our neighbor planned on buying at the premarket limit price of $35 a share. He got distracted by a telephone call and didn't place the order. As expected, the stock immediately gapped up 3 points a few minutes after the opening bell. He was so annoyed he didn't buy the stock at $35 a share he placed a market order, hoping to make a profit on the strong upward movement of the stock. He got it at $38 a share, just about the time most day traders abandoned it. Within minutes, the stock fell back to $35. He held on, watching in disgust as the stock plummeted to $19 a share a few weeks later.

In this example, a lack of knowledge about technical analysis combined with a refusal to cut losses added up to a substantial loss. In fact, when losses do occur, it is often not one mistake but a combination of mistakes that will lead to loss of capital. Although our neighbor was knowledgeable about the market, that wasn't enough to prevent him from making a number of obvious mistakes. That is another reason why it is so essential

that you learn more about how the after-hours market works than the competition knows.

NO TIME FOR R&R

Quite a few after-hours critics believe that people who trade stocks at night won't have time for R&R, that is, research and reflection. One of the keys to being a successful trader is taking the time to investigate profitable trading opportunities and then acting on them. This also means putting time aside to reflect on your long-term and short-term strategies and routinely reevaluating the trades you make. Some of your best trading ideas will likely occur not when you are trading, but when you are far away from the after-hours action. Einstein once wondered why some of his best ideas came while he was in the shower. And you probably know the story of the Greek mathematician, Archimedes, who got the idea for the law of hydrostatics while sitting in his bathtub, running out of his house yelling, "Eureka! Eureka!" (I found it! I found it!). We don't mean to imply that you should get your stock ideas from standing in the shower or sitting in the tub, but then again, anything is possible.

If you work all day and trade all night, some are concerned your R&R will be inadequate. Once again, we can't protect you from yourself, but we can urge you to use your time wisely, allowing for opportunities for research and reflection as well as rest and relaxation. Although many people think that the longer and more often you trade, the more money you'll make, the opposite is often true. The goal in business as in trading is to use less of your time to make more money. This will give you the freedom to pursue the things in life that are really important to you.

MANIPULATION

Manipulation can be a problem when you have open limit order books. One unethical strategy used by some sophisticated traders

is to put in large fake buys or sells in the limit order book to trick other traders into thinking there is depth and support for a particular stock. We can't emphasize enough that these strategies are unethical and are activities that are never engaged in by ethical traders and investors. The only reason we describe them here is so you will not fall victim to them.

The strategy of making fake bids and offers is frequently used on certain momentum stocks. For example, let's say an unethical individual owns 500 shares of BadBoy (BAD) and wants to sell his shares at a higher price. He could engage in a number of legal but unethical activities designed to make the value of the stock go up. First, he could go in the financial chat rooms and drum up investor interest in the stock, leading people to believe it is a momentum stock play. He could sign on with dozens of different aliases, fooling people into believing there is broad interest in the stock. Then he'd enter fake 5,000-share orders on the limit order books, and report back to the chat rooms how hot the stock looks. He could send out mass e-mails, and if affiliated with a stock boiler room operation, call strangers on the phone to drum up more buying interest. If he has official contacts, he could send out pumped-up press releases initiating coverage on the stock. This approach will likely snare quite a few naïve traders desperate to make money on the next momentum stock, thinking that this is the stock play of the week.

Experienced traders have learned to take a pass on this type of publicity hype and to ignore fake bids and offers on the limit order books. This kind of manipulation is relatively common, so you do have to be on guard to avoid becoming a victim.

Another type of manipulation that is quite similar to the above example can be described as "walking up" a stock. A trader or group of traders tries to manipulate a stock, often a penny stock that is priced at less than $5 a share, by creating the illusion of activity and price appreciation. We call it walking up a stock because it can best be described as walking up a flight of stairs.

The manipulators will often buy an obscure stock late in the day near the close. Because many penny stocks are traded so infrequently in the after-hours market, it is easier for unethical individuals to attempt to control the price. For example, after

the market makers are gone for the day, the scam artists will start the manipulation. It consists of trading shares back and forth without any net change in the position. Let's say the stock closes at 1⅛. They put in a sell order at 1¼ and subsequently buy it from themselves. They keep repeating this activity over and over until the stock hits a most active list or biggest gainers list. Of course, they are also posting messages in various chat rooms, trying to stir up additional interest in the stock. As the stock increases in price and volume, novice investors may try to participate in the momentum. This is when the manipulators sell their shares.

There are a couple of rules that you should remember. First, it is risky enough to trade penny stocks in the regular market, but in the after-hours market it could be downright dangerous. If you aren't careful, you could become a victim of a number of investment scams that target greedy, unknowledgeable traders. Once again, if you stick with larger, well-known market leaders that have broad institutional support, especially after hours, it shouldn't be difficult to avoid many of these trading scams.

POWER OUTAGES AND CYBERSABOTAGE

It is really irritating not being able to place a trade during the day or night because your online brokerage lost power or had a system interruption. When this happens, even if you try to place a trade by phone, the line will be busy because everyone else is trying to call at the same time. It makes you wonder what would happen if there ever was a market crash, similar to what happened in 1987. We can pretty much predict that only a few traders, perhaps a handful of professional traders with direct-level access, would get through to the floor of the exchange. One of the advantages of the after-hours market is if there is a daytime system crash, you can use the nighttime to play catch-up.

Nevertheless, system crashes will cost you money. The truth is that nearly all the online brokerages, and occasionally, the stock exchanges, have intermittent system crashes but are very shy about publicly admitting how many. It doesn't matter if it

happens during the day or night; a system interruption can ruin even the most profitable game plan.

A system interruption can make it impossible to determine if your order went through or not, causing you to enter the order twice. In the worst case, it can prevent you from getting out of a losing position.

It is the fear of not knowing what is happening to your stocks that is probably the worst fear of all. Unlike 1987, today's trader is much more knowledgeable about what is going on behind the scenes, thanks in large part to the Internet. However, all the knowledge in the world can't stop a system interruption.

Although system interruptions are not routine, they do happen often enough to cause concern. One solution is to have two accounts. In case of emergency, you can switch to your second account. We actually think it's a good idea to have two accounts. We use one of our accounts for long-term investing and the other for short-term trading, including after-hours trading. This could also protect you in case one of your online brokers has a technical glitch.

Another annoying but growing problem is coordinated cybersabotage attacks. A common scenario is for a group of computer vandals with high-speed computer access to send gigabytes of fake requests for information to an Internet web site, clogging up the system when the server tries to process the request. To solve the problem, the system programmers have to temporarily shut down the site, forcing you to do your business elsewhere. In this case, having a second brokerage could be extremely useful.

THE PRO'S ADVANTAGE

As we mentioned earlier, professional traders, including institutional investors, used to get all the breaks. First of all, they've been trading after hours among themselves for over 30 years, giving them a huge advantage over retail investors who are just now getting accustomed to the idea of after-hours trading. Second, the market makers and specialists were primarily the only ones to

see the depth of the limit order book, that is, the number of limit orders waiting to be filled. This allows the professional trader a huge lead over retail investors because the pro knows the number of other buyers who are waiting to get filled and the size of the orders. For example, if you were a market maker and you knew in advance that a million-dollar sell order was about to be filled, you could sell any shares you personally owned at the current market price. Then you'd fill all the outstanding buy orders. When the million-dollar sell order crossed your desk, you'd benefit from both sides of the transaction, selling high and buying low. Because the pros can see the hands of both the buyers and the sellers in a stock, they can create profitable strategies based on this inside information. They act as the house with one distinct advantage: They can see what everyone else is doing. It is important to note that trading ahead of customers is not allowed during the day but is allowed before the markets open.

There is little doubt that some pros are looking forward to mixing it up with retail investors in the after-hours market. To some, it is probably an easy way to make some extra money from unsophisticated traders who are participating in the after-hours market for the first time. This is one of the reasons it is so essential that you gain knowledge and experience before placing after-hours trades. The after-hours market is not a place for amateurs or for those seeking a night's entertainment. After-hours trading is a real and serious business, and it is essential you do everything in your power to compete equally with other traders.

A way to avoid getting into trouble is to stick with the stocks of companies you know well and are heavily traded. It doesn't make sense to buy stocks in companies you never heard of when you can buy shares of heavily traded issues like Lucent (LU), Vitesse Semiconductor (VTSS), Sun Microsystems (SUNW), and dozens more. Stick with stocks that are attracting institutional buyers and are routinely mentioned in newsletters and on television. Since you can't always beat the professional investors, you might as well join them, especially at night.

It is not just the pros who are seeking to profit in the after-hours market. Experienced individual traders could use the after-hours session to pick up a few extra bucks from novice individual investors. There are a number of tricks experienced traders can

play to foil beginners. Because we believe that knowledge is your best weapon, you will notice that we reveal a number of these strategies in this book. Tread lightly, but arm yourself with knowledge and experience.

The more you know how the markets really operate, the more successful you will be. Although the pros will always try and tilt the advantages in their favor, Wall Street is slowly changing, whether the pros like it or not. Eventually, some of the games the pros play, like playing hide-and-seek with the order books and payment for order flow, will be eliminated. In time, as retail investors learn what really goes on in the back rooms of their brokerages, the system will be redesigned so that one side doesn't get to take unfair advantage of the other. Until the day comes when the stock market doesn't resemble a casino or a used car lot, it is best to keep at least one hand on your money at all times.

REVENGE TRADING

Another fear of government regulators and organizations concerned with protecting the rights of individual investors is revenge trading. It refers to online traders who lose money during the day and then compulsively try to win it back during the night. It is more akin to gambling than trading—and with the same end result: loss of capital.

If people want to trade 12 or 24 hours a day in a desperate attempt to win back lost money, there is little we can do about it. If you are using the after-hours market to try and get even with losing stocks, then you need to reevaluate your trading strategies and implement strict money management controls or perhaps even find another way to earn extra income. If you are a revenge trader, especially one who takes every loss personally, you'd probably be better off investing in a mutual fund or index fund because otherwise it will only be a matter of time before you lose more money than you start off with. The market is an unforgiving place for people with too much money and too little self-discipline. If you are determined to succeed as an after-hours

trader, you need to adopt the characteristics of the successful traders we described in Chapter 6.

POOR ORDER FILLS

When you place an order for a stock, there is no guarantee that it will get filled at the price you want, or whether it will get filled at all. Remember that a market is made up of two entities, a buyer and a seller. If there is no one on the other side of a trade, the order will not be matched. In an extreme example, let's say a stock closes at $100 and you put in an order to buy it at $75. Even though it is at a huge discount to the market, it will not get filled unless someone inadvertently sells it to you at that price.

During the regular market, if you put in a market order with your online broker, although you should get filled immediately, it could take several seconds or minutes. Perhaps this doesn't seem long, but if you are a professional trader or are participating in a fast market, a few minutes will feel like a lifetime. Keep in mind that when you place a market order, you are substituting fast execution for almost no price improvement. This means that although you should get filled immediately, you will likely get the highest price for the stock if you are buying or the lowest price if you are selling. Since market orders are not allowed during the after-hours market, at least not yet, you avoid many of these problems. As we have stressed many times throughout this book, it usually makes more sense to place limit orders.

However, even with a limit order, you can get poor order fills during after hours. This can happen for a number of reasons. First, if there is a lot of buying or selling interest in the stock, the price might rise so quickly that your limit order may go unfilled. Remember that when you place a limit order, you are trying to match your order with that of another buyer or seller for the price you specify. If there is no buyer or seller at the specified price, you will not get filled.

If you are determined to get your order filled in the after-hours market without regard to price, then pay close attention to

the ECN limit order book. This is the most convenient method of learning if the limit price you select is near the latest bid and ask price. Place your order at or near the best bid or ask price and it is likely the system will find a match.

BEAR MARKET

A number of critics have said that when we enter the next bear market, that is, consistent market losses of over 10 percent, people will no longer have an appetite for after-hours trading. There is little doubt that an extended bear market could squeeze the life out of the U.S. markets. After all, you need a lot of people willing to trade stocks to make a market. The only market that traders fear the most is a flat, thinly traded market with few buyers and sellers. Traders don't care about short-term corrections as long as there are buyers and sellers.

As we've said before, short-term traders really clean up during a correction because they will sell short, that is, sell a stock and then buy it back at a lower price. In other words, you do the reverse of going long. It is an excellent strategy when done correctly, although it can be fraught with risk. It is best if done as a short-term trade.

If we do enter a bear market, then you should use the time to study the markets and look for other opportunities to make money in the market. One strategy is to target those stocks that would be ripe for a rebound once the bear market is over. This is what happened in Japan. After suffering through an 8-year recession and a flat, unenthusiastic market, a number of the stocks rebounded sharply from all-time lows. Those traders with patience and the capital to back it up can do well during any kind of market condition.

If there is a bear market, you can do a number of things, like look for stocks to short, shift more assets into cash or bonds, and become more selective about the trades you do make. When the market recovers, and it eventually will, the after-hours market will still be there. Our belief is that once people get a taste of the

convenience of the after-hours market, they'll demand more time to trade, not less.

BEWARE OF AFTER-HOURS PRICE MANIPULATION

Does price manipulation really happen in the after-hours world of trading? Absolutely! The good news is, however, that you can learn to recognize when stock prices are being manipulated. Once you do, we hope you won't be thrown off course by it, and more importantly, it will prevent you from losing money.

Although there are several different ways someone can manipulate the price of a stock in the after-hours, one of the more common ways (as noted earlier) is to place fake large-share-size orders to create a false sense of buying or selling pressure. Let's take a closer look at manipulation and how to recognize it.

Since retail investors are currently creating most of the after-hours trade volume, the average share size is typically small, ranging anywhere from 100 to 1,000 shares per order. This is obviously because the average investor is generally not going to have enough capital to buy 5,000 shares of any mid- to high-priced stock. However, in the case of manipulation, you will see much larger share sizes.

Essentially, the manipulator, who could be anyone, day trader or professional, will place a large order of anywhere from 3,000 to 5,000 shares on either the bid or the offer side of an ECN's limit order book for a particular stock. The side the person places the order on is typically dependent upon which way the person wants the stock to move, that is, either up or down. When these orders are placed, they are usually placed at least one price level below the best bid or best offer. This means that the orders will not get executed, but will appear to all the other traders in the limit order book. This large order is being placed in an effort to "scare" people into buying or selling shares. The theory is that if you see a large order on the sell side, you will be scared into selling your shares also.

However, it is important to understand that the orders are fake. The manipulators have no intention of letting their orders get executed. Instead, these manipulators will cancel their orders as soon as their price becomes the best offer or best bid. In this way, they are attempting to manipulate the price of the stock. If they can scare some people into selling their shares at a cheap price as a result of the fake large order, they can then buy up those shares for their own account. Once everyone is scared out of the stock, of course, they can let the stock run higher. Likewise, manipulators will often place fake large orders on the buy side in an effort to draw in buyers so that they can sell their own shares or sell short the stock.

How do you know when someone is trying to manipulate prices? Fortunately, it is fairly easy to detect if you know what to look for. Whenever you see a large buy or sell order in an ECN's limit order book, take note of the price level of the order. If the order is large, but is sitting at the best bid or best offer price and is not quickly being changed to a different price, the order is most likely legitimate. Whoever is behind the order most likely wishes the order to be filled and that is why the person is leaving the order at the best bid or offer price.

On the other hand, if the order is constantly being removed or changed to a different price every time that order becomes the best bid or best offer, most likely some sort of price manipulation is at work, and it is best to stay away from that stock. Keep in mind that manipulators do not want their orders to be executed, so they would rarely let their order sit at the best bid or best offer for more than a second or two. Although you could enter the position and just ignore the fake orders, we personally prefer to stay away from the stock altogether. It is obvious that someone has some sort of hidden agenda, and we would rather not be involved with it, especially if it might cost us money.

While we are not advocating a conspiracy, we are just trying to make you aware of some of the games and tricks that professional traders can play in an attempt to scare people out of or into positions. Being aware that these things happen is the first major step toward protecting yourself. More importantly, if you know how to tell the difference between price manipulation through fake orders and actual real orders, you are way ahead of

the game and one step closer to becoming a successful after-hours trader.

STAY AWAY FROM PENNY STOCKS IN THE AFTER-HOURS MARKET

If you look at the stocks on the most actives list in the limit order book each night, some of them may be ones you have never heard of. In fact, many of them are stocks that we refer to as "penny stocks," meaning that the price at which they trade is very low, usually under $5 per share. Although there are many traders who successfully trade these types of stocks, we recommend that you avoid trading them unless you are an experienced trader. Here is why.

Since these stocks typically don't have a lot of shares outstanding and usually have average low daily volume, it is very easy to manipulate prices. Another problem is that penny stocks are extremely volatile, making very sudden and sharp moves, which do not typically last long. Most traders find that by the time they buy the stock, it has already made its upward move and is on its way back down. In the after-hours market, this inherent volatility can be even more pronounced.

In addition, penny stocks that are selling for under $5 cannot generally be sold short. In order for a stock to be sold short, the stock must be marginable, which means the price must be at least $5. Trading penny stocks cuts your ability to make a profit in half since you can only buy the stock, not sell it short.

Although many people like trading penny stocks because they are cheap, we recommend that you avoid them because they are so unpredictable and time-consuming. One of our acquaintances bought thousands of shares of a penny stock called Unigene (UGNE) when it was selling for $3 a share. Sometime after his purchase, it fell in price. For 2 years he watched this stock steadily drop to less than a dollar until it finally reversed direction and broke past $4 a share in early 2000. Although our acquaintance finally realized a substantial profit on UGNE, he spent a considerable amount of time and energy tracking it.

Actually, it was the only stock he talked about. We think it is smarter for most investors to focus on the stocks of companies you have heard of, stocks that are followed by professional analysts and that are shares of companies that make products you actually use.

HAVE A BACKUP SYSTEM

Although online trading has become very fast and simple, no technology is 100 percent infallible. Always keep in mind that you may be shut out of an after-hours trade due to problems with your Internet provider or technical problems at your brokerage. Sometimes it will be just a simple delay of a few seconds; other times it may be a complete system outage lasting several hours. Be prepared to deal with this frustration and have other options for placing your trades.

Some brokers offer alternative methods of trading if their online systems go down, but these other channels can become overloaded quickly as well when problems arise. It can sometimes take hours to get through to a broker that is having technical problems or during very busy trading periods. We know what it feels like to see our profits erode right before our eyes and be powerless to do anything about it. We've also had our own share of missed opportunities. But these are the pitfalls of online trading, and you need to be prepared for them.

In case of system failures, have alternative trading resources available, such as the telephone, a live broker, or multiple online brokers or Internet providers. During one long outage, we even had to fax our orders into the broker, so a fax machine or fax computer modem may be another option for you. Beware, however, that many brokers do not have telephone support available for after-hours trading. Check your broker's policy, and make some backup plans accordingly.

Whatever alternatives you decide to use, be sure to know your options beforehand and be prepared to use them when necessary. The best advice we can give you in this regard is much more basic: Never put yourself in a position where your entire

account depends on making any one trade. It isn't worth the aggravation and the possible damage to your portfolio.

DON'T THINK YOUR AFTER-HOURS ORDER IS EXECUTED AS SOON AS YOU PRESS THE SEND BUTTON

Keep in mind that the transmission of an order over the Internet doesn't necessarily mean that the order will be executed, especially in after-hours trading. Because you must submit only limit orders to the ECNs, it's very likely that your order may not be filled at all. Moreover, even if an order is executed, you may not receive a confirmation notice right away for a number of different reasons. Do not presume that the execution of an order has not taken place just because the trade hasn't been reported back to your account. If you try to shut down or reboot your computer to resend an order, chances are good that you might unintentionally submit a duplicate order. In fact, we have seen investors with double and triple the number of shares they wanted because they unknowingly submitted multiple orders. If you can't tell if your order was executed by looking at your broker's screens, contact your broker directly. When in doubt, do not place another order.

IF YOU PLACE A CANCEL ORDER, MAKE SURE IT GOES THROUGH BEFORE YOU PLACE ANOTHER TRADE

The same duplication principle we discuss in the above strategy also applies here. Because of the way current online systems operate, you may have difficulty canceling or changing an order due to reporting or confirmation delays or technical problems. If you can't tell whether or not your order has been executed, how

can you cancel or change it? The best strategy, therefore, is to not place a second order until you are absolutely certain that your order was canceled. Another strategy might be to use a change order rather than canceling your order and entering a new one.

IF YOU PLACE A TRADE IN THE REGULAR MARKET SESSION, DON'T DUPLICATE IT IN THE AFTER-HOURS SESSION

Let's say you want to buy a stock in the regular market session and your order does not get filled. You really want this stock, though, so you decide to place the same trade in the after-hours or the premarket to see if you can get the trade to go through. Remember, since most ECNs treat the after-hours market as a totally separate market, you will usually have to place a new order. (Island ECN, however, allows you to place a day limit order, which is good throughout the extended-hours session as well as the regular trading session.) You finally get your order filled during the after hours at a price a little higher than what you intended to pay, but at least you now own the stock you wanted. The only problem is, you forgot to cancel the original order. Guess what happens next: When the regular market opens, your original order gets filled again. Not only do you now own the stock, you own twice as much of it, and you owe your broker twice as much, as well.

To protect yourself from incurring such losses, make sure to verify that you have canceled an order in the regular session before placing the same trade after hours. In fact, let's take this one step further: Be sure you have received a firm confirmation of your cancellation in the regular session before you place a new trade for the same stock in the after-hours market. It is your responsibility, not that of the online brokerage, to make sure you don't enter duplicate orders. In fact, every web site we examined has disclaimers to this effect, so you need to be careful. To be safe, we suggest that you just don't place the same order in both markets—at least until you become much more experienced with after-hours trading.

THE RULES

Now that you have a better idea of the risks and rewards of after-hours trading, it is time to learn the rules of the after-hours market. As you will discover when you read the next chapter, the rules for after-hours trading have not been finalized. That is why it is so important that you learn exactly how the game is played before you make your first trade.

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SECTION III

END GAME

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THE RULES OF THE GAME

Like any game, the after-hours market has a unique set of rules. It is essential that you understand these rules before you play the game. Because after-hours trading is so new, the rules of this particular game are sometimes confusing. Most important, for the after-hours market to be a success, the participants must have confidence that everyone is playing fairly. This is the only way to establish a credible market and prevent one group from taking unfair advantage over another.

There is little doubt that the final rules for the after-hours market will ultimately determine the success or failure of this new trading system. If the rules for the after-hours market are fair and equitable to retail and institutional investors, then it will be a huge success in spite of the dire predictions of some on Wall Street. If, however, individual investors feel the rules still favor the major institutions, then people will be hesitant to participate.

It took many years for people to have enough faith in the regular stock market to invest. In times of crisis, most notably in 1929 and 1987, government regulators passed additional rules and regulations designed to instill confidence in the financial markets. Perhaps the markets were shaken a bit during these times, but they definitely survived and became stronger.

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Since the after-hours market is a new playing field, it created a whole new set of problems for regulators. In the early days, it was every ECN and market for itself. In the rush to set up the technology for after-hours trading, all the ECNs played by their own set of rules. Although the SEC, the government agency in charge of the stock market, encouraged competition among the various market participants, including stock exchanges and stock markets, it was hesitant to tell them how they should run their companies. As a result, the ECNs and online brokerages were responsible for creating guidelines that customers thought were fair and equitable. The SEC decided to act as facilitator, bringing all the market players together to discuss the major issues. The SEC preferred to have the members of the securities industry govern themselves, to agree on a standard set of rules and play by them.

To alleviate some of the concerns of the member firms and keep everyone on the same page, the SEC, the NYSE, and the NASD invited representatives from all sectors of the securities industry to participate in a series of discussions that would focus on specific after-hours issues. Considering that the various groups had conflicting interests, it was a step in the right direction, at least to get everyone talking to each other. In addition, members of Congress, specifically Senators Rod Grams and Chris Dodd, invited SEC Chairman Arthur Levitt and the CEOs of a half-dozen ECNs to come to Capitol Hill to discuss how ECNs are affecting the way that Wall Street does business.

In this chapter we attempt to make you aware of the major issues that still need to be resolved before the after-hours market is enthusiastically accepted by individual investors. You should keep in mind that the rules and players are changing rapidly. And so while we did our best to correctly analyze how the after-hours market will evolve, some of the rules in this chapter may even be eliminated by the time you read this book.

If the after-hours market becomes as wildly popular as we expect, with hundreds of millions of shares traded each night, then the after-hours market will likely have the same rules as the regular market. The after-hours scene is changing so rapidly, it is hard for anyone to predict accurately how it could play out. To help us develop this chapter, we talked to dozens of market experts and financial consultants, many of whom attended the

working group sessions. We even talked to all the major government agencies, including the SEC, for additional analysis.

Although it's difficult and time-consuming to get everyone to agree on a standard set of guidelines, we hope we end up with a market considerably more fair than what was established over 200 years ago. We've come a long way since a group of men stood under a Buttonwood tree in New York City and agreed among themselves to take a 25 cent cut of each order. It took a long time before the needs of the retail investor were even considered.

No matter how the following issues are ultimately decided, they still need to be discussed. Although it is anyone's guess how the after-hours market will evolve, we are certain of this: Our financial markets are going electronic at eye-popping speed.

WHAT ARE THE HOURS OF OPERATION?

Although many ECNs were willing and able to trade 24/7 in the early days of after-hours trading, it was up to market participants to determine the beginning or ending hours of extended-hours trading. For example, a few ECNs, like Island ECN, ran continuously from 7:00 a.m. to 8:00 p.m. Other ECNs, like MarketXT, started a bit later, for example, at 4:01 p.m. EST. The Chicago Stock Exchange, on the other hand, stayed open until 6:30 p.m. EST. Nasdaq, in cooperation with the after-hours participants, allowed its electronic quote system to stay open until 6:30 p.m., with a plan to extend it as late as 8:00 p.m.

Although many of the ECNs stayed open late, it was up to the brokerages to adjust their hours to meet the needs of their customers. For this reason, it was rather confusing. Among the major market participants, the only hours-of-operation rule they agreed on was that the after-hours market would close no later than 10:00 p.m.; and although most ECNs ran until 8:00 p.m., quite a few ECNs set up technology to go 24 hours a day.

The hours of operation are actually a contentious issue on Wall Street, especially for the smaller member firms. The longer a broker-dealer (a registered firm that buys and sells securities from its own or its customers' accounts) stays open to serve the

needs of after-hours customers, the more it costs for overhead and extra staff. Unlike ECNs, which operate with a minimum of human interaction, the brokerages need a relatively large staff to help process orders, run the computer equipment, and answer customer questions.

Although large brokerage firms like Merrill Lynch, Goldman Sachs, and Salomon Smith Barney have the resources to hire additional staff and pay for overhead, the smaller member firms do not. As market makers and specialists officially get involved in the after-hours market, it will be difficult for some of the smaller firms to justify paying one or two professional traders to make a market. Obviously, if the liquidity is there and after-hours trading becomes even more popular, then the costs for extra staff and overhead will be justified. Until then, the smaller brokerage firms are taking a wait-and-see attitude. Some have even talked about merging, especially if after-hours trading activity increases.

Some of the member firms on the NYSE and the Nasdaq want the after-hours market to close from 4:00 p.m. to 5:00 p.m. so they can adjust their books and reboot their computer systems. Although this is what many in the industry would like, it is doubtful the 5:00 p.m. starting time will be very popular with the public. After all, one of the advantages of after-hours investing is the ability to trade after 4:00 p.m. EST in time for any late-breaking corporate news. If the 1-hour "break" is allowed, it takes away one of the main advantages of the after-hours market. In our opinion, if the retail investors are really going to be on a level playing field with institutional investors, the retail investors should have equal access to the markets in order to trade on news as soon as it is released and not an hour later.

The reason there is an 8:00 p.m. EST closing time for after-hours markets is related to how orders are processed. Under the current computer configurations, it is difficult to process orders after 8:00 p.m. in time for the next morning's opening. According to system specialists, on higher-volume days it can literally take all night to process customer orders in time for the next morning's opening. Although it is possible to reprogram the computers to process orders faster, it could involve hiring additional staff. There is little doubt that the system problems related to back-office order processing will eventually be speeded up,

allowing for even longer trading hours, well past 10:00 p.m. and eventually 24 hours a day.

A related issue involves dividing the trading day into three sessions. Rather than creating an extended, continuous market, many major players want to divide the market into three separate sessions, each with a start and finish. In this case, the after-hours market would be a distinct market with its own set of rules and regulations. At this time, the online brokerages do consider the after-hours market as different from the regular market.

When you sign onto the brokerage, you can see that it handles an after-hours order somewhat differently. To enter an after-hours order, you are required to read a disclaimer disclosing the risks. You are then led through a series of screens that are somewhat different from those of the regular session.

In the end, it will take some time before everyone agrees on a standardized start and finish. Industry insiders say that competition will eventually determine who will stay open the longest. After all, not everyone is willing to be the Denny's or 7-Eleven for the stock market, but we can promise you that some will. If you, the retail investor, show a willingness to trade late at night, it is guaranteed someone will stay up to take your order. If the ability to trade after hours is important enough to investors, brokerages will be forced to make changes or lose customers.

CAN I SELL MY STOCKS SHORT?

Short selling is a very fascinating strategy used by a number of sophisticated traders. Basically, when you short a stock, you are betting that the price of the stock will go down, not up. Therefore, you first have to sell the stock, or borrow shares from your brokerage, and then buy the stock back at a lower price, pocketing the difference. If you are correct and the stock goes down, you can do well. The risk is that if the stock goes up, not down, your potential losses are unlimited. When you go long a stock, the most you can lose is the total of your investment. When you go short, your losses are unlimited, although most experienced traders will set up strict stop losses before major damage occurs.

The wonderful part about shorting is that you can make money during short-term corrections or lengthy bear markets. It sometimes surprises people that you can make as much money when the market is going down as when it is going up. Although it is a risky strategy if you lack self-discipline or money management skills, shorting is very effective if used properly. Keep in mind, however, that stocks fall much faster than they go up. Selling stocks short, especially during extended hours, can be fast and volatile. It is definitely not for risk-averse traders.

The after-hours market actually provides savvy investors an unusual trading opportunity, at least for now. During the regular market, there is a rule that forbids short sellers from selling a stock short unless there is an uptick in the stock. The uptick rule prevents traders from shorting a stock in a downtrending market. A security may not be sold short unless the previous trade was executed at a price higher than or the same as the short-selling price.

Although the uptick rule is somewhat controversial among the pros, the purpose is to prevent a crowd of short sellers from piling on the stock, forcing it to drop even farther. The interesting part is that the uptick rule for the after-hours session was suspended by the SEC. This means you can freely short a falling stock without worrying about the uptick rule.

This would give savvy investors an unusual opportunity to short a stock during the after-hours market, especially if bad news was announced. For example, Cellstar Corporation (CLST) closed at $11 on December 29, 1999. Around 9:15 a.m. the next morning, CNBC mentioned that the company had just announced that once again its earnings would fall short. On the news, the stock fell by 2 points on the Island ECN, to $9\frac{1}{16}$. Because there was no uptick rule, you could have sold the stock short at $9\frac{1}{16}$. On the regular market open, it immediately fell to $8\frac{5}{8}$, as the regular market participants woke up to the news and began selling.

Although the uptick rule doesn't apply to the extended-hours session, it is our guess that eventually it will be required during the after-hours session. The main reason it doesn't apply after the regular close is that the "directional arrow" technology hasn't been developed for the ECNs. Until it is, take advantage of

this loophole by reading the chapter for experienced day traders (Chapter 9), where we describe short-selling strategies.

Finally, you will have to check with your brokerage to determine if it allows you to short during the after-hours session. Because of the volatile nature of shorting combined with a possibly illiquid after-hours market, it is probably best if you don't short during extended-hours trading until you gain more experience.

WHEN WILL BREAKING NEWS BE RELEASED?

As we've said a number of times, knowledge is the most effective weapon you have in making sure you get the same opportunities to profit as the pros. As you know by now, one of the reasons stocks move dramatically is based on breaking company news. In fact, companies traditionally wait until the regular market closes before they release news. Companies claim that by releasing news at 4:00 p.m., after the market closes, they won't adversely affect the price of their stock. Now, with the advent of the after-hours market, there is really no time that is safe to release corporate news.

We don't mean to imply that companies are trying to deceive investors by releasing news after the closing bell. The reason they do this is so there will be ample and equal dissemination of news. They want all investors to receive and digest the information. You can, however, take advantage of breaking news by reacting first.

At the same time, you should know that a strategy based on breaking news releases could be risky and difficult. To make money, not only do you have to be on the right side of the news, but you have to be first. For example, let's say Dell announces after the market closes that it made 48 cents a share this quarter, a huge improvement over last quarter. You assume the news is good, so you buy Dell in the after-hours market at $47 a share, the current limit price being offered. If the pros, however, determine

that Dell should have made 50 cents this quarter—what many call the "whisper number" (what professional investors privately expect the earnings to be)—there will be massive selling by institutions. You were first, but if you were wrong, you could find yourself with substantial losses. In this scenario, Dell dropped to $42 a share, costing you a quick 5 points.

Although there are risks involved with buying or selling on the news, this is one of the main reasons retail investors asked for an after-hours market. For this reason, it is likely the competition will force all the ECNs to allow continuous trading, and prevent institutional investors from having an unfair advantage. Traders are not interested in waiting while their online brokerage shuffles papers in the back office when there are opportunities to make money.

HOW WILL AFTER-HOURS TRADING AFFECT MUTUAL FUNDS?

One group clearly wringing its hands over the emergence of after-hours trading is the trillion-dollar mutual fund industry. Although members of this group have been trading after hours on Instinet for a long time, this is the first time after-hours trading could have a direct impact on the way they do business. At 4:00 p.m. every afternoon employees from each mutual fund company calculate the net asset value (NAV) of each fund. They add up the total value of all their holdings and divide it by the number of outstanding shares. The NAV is then used to calculate how much each customer's account is worth. After that, the NAV is passed on to the newspaper, which publishes the results in the paper every morning.

As we move to a longer trading day and into the night, the 4:00 p.m. hour is nothing more than a snapshot of what happened at one point during the day rather than your final account balance. In fact, after-hours proponents say there should never be a closing price, but instead there should be various snapshots in a continuous 24-hour market. For example, they could calculate prices twice a day, at 4:00 p.m. and at midnight.

Easier said than done, argues the mutual fund industry. First, it takes an inordinate amount of resources to make these calculations. If the mutual funds had to do another calculation at midnight, for example, they'd have to hire additional staff and pay for overhead, which would be passed on to you, the retail investor. In addition, if they had to calculate the NAV at midnight, it would also delay when this information would be put in the hands of newspapers, although a midday calculation could make it in time for the afternoon papers. Because of this, it is likely the 4:00 p.m. EST NAV calculation will continue for some time.

In the future, nearly everyone agrees that computer systems will be designed so that customers can find out the value of their accounts 24 hours a day. Instead of individual snapshots, there would be a "streaming portfolio," providing instantaneous updates of your account. It might seem hard to imagine, but at 3:00 a.m., after a restless night, you could turn on your computer or wireless device and instantly find out what your stocks or mutual funds are doing.

The mutual fund companies are also concerned that intraday pricing of mutual funds might encourage people to day-trade mutual funds, a controversial practice discouraged by the mutual fund industry. Most mutual fund companies want to attract long-term investors, not short-term traders. They absolutely hate when people shift in and out of funds during short time frames. In fact, several mutual fund companies penalize customers who engage in this practice by kicking them out of the fund or adding redemption charges.

We have acquaintances who use short-term trading strategies with their mutual funds using payroll deduction plans. If mutual funds are calculated at various times during the day, our acquaintances will be the first to find ways to take advantage of short-term strategies to increase their profits. There are, however, a small number of mutual fund companies that perform intraday calculations, allowing customers to engage in short-term trading tactics.

For now, the mutual fund industry is taking a wait-and-see attitude on after-hours trading, realizing that this market is not going away, but hoping it won't dramatically change the way they do business.

HOW WILL THE AFTER-HOURS MARKET AFFECT NEWSPAPERS AND TELEVISION?

The emergence of the after-hours market affects not only the people who work and do business on Wall Street but also anyone who reports on the market. In particular, newspapers and financial television programs are directly affected by extended market hours.

CNBC and CNNfn were the first to expand their coverage of the premarket and after-market activity, hiring a reporter who primarily covers after-hours activity. Each night, after the market closes, the reporter discusses the most active stocks on Instinet and Island, the two largest ECNs at this time.

Newspapers, as you are well aware, have deadlines to meet, so giving readers the latest quotes in time for next morning's paper is quite a challenge. Although newspapers can receive quotes as late as 6:00 p.m. and still make the morning deadline, it isn't easy. Only a few newspapers have created special sections devoted exclusively to after-hours market activity, although this could increase as interest in extended hours grows.

For the most up-to-date market activity, you will need to log onto the web sites devoted exclusively to after-hours market activity, such as www.MidnightTrader.com, www.afterhourtrades.com, and www.TheStreet.com, to name a few. A full list of web sites devoted to after-hours trading is included in the Appendix. In addition, after-hours traders closely monitor news sites such as www.marketwatch.com and www.yahoo.com for breaking news that could affect stock prices.

As the liquidity increases and more people participate in after-hours action, there will be even more media coverage. Although it might seem unlikely as we begin the twenty-first century, a 24-hour global financial news network is a real possibility. It wasn't too long ago that people dismissed the idea of even a 12-hour news station because it would be too boring, but CNN proved the critics were wrong. And perhaps some of you remember when the major television stations went off the air around midnight, treating viewers to a simulated air raid siren and a multicolored corporate logo. Believe us, a 24-hour global market will bring a 24-hour global financial television network.

WHAT KIND OF ORDERS WILL BE ALLOWED?

The one rule that nearly everyone agrees on is that customers should only be allowed to enter limit orders after the market closes or before it opens. Market orders should not be allowed. Why? To protect after-hours traders from wild price swings. To review, with a limit order, you must specify the price you are willing to buy or sell the stock before you can place the order. Contrast that with a market order, which is an order to buy or sell at the current price. In addition, other variations of the market order are not allowed, including the good till canceled (GTC) and the fill or kill (FOK). These restrictions, however, will likely be lifted as the liquidity improves and the after-hours market begins to resemble the regular market.

We strongly believe in limit orders and think that all retail investors should use them in both the regular market and the after-hours market. Limit orders protect investors from purchasing stocks at inflated prices. When you place a market order, you will get the national best bid and offer (NBBO) price, a rather misleading title. Instead of receiving the best bid or offer price, you are often matched at the worst price (a high ask or low bid).

As we discussed in Chapter 3, your market order is so valuable to market makers and specialists that they routinely pay millions of dollars for payment for order flow, a controversial practice some critics call a bribe. PFOF is designed to encourage brokerages to route orders to them in return for a payment. We know of one major online brokerage that earns almost 25 percent of its income from market makers who pay it for order flow. If you don't think the brokerages care about your market order, think again. It means big bucks to the brokerages and to the market makers and specialists who handle your order.

For individual investors, the limit order rule makes the most sense. When you place a market order, you are putting yourself at the mercy of the market, allowing those who have conflicting interests to fill that order. On one hand, says Matt Andresen, CEO of Island ECN, middlemen serve you, and on the other hand, they profit from you. In an auction place like the

market, the pros will try and squeeze out the highest possible price from you. They also have an incentive to earn back the millions of dollars they paid to the brokerages for PFOF. To its credit, Datek Online was the first online brokerage to actually return the PFOF to the customer for a credit, a practice we believe other brokerages will emulate.

Is there a time when market orders make sense? Only if you are a momentum growth investor trying to ride a fast-rising stock and you don't care what price you get. This is a tough game to play, but it has been successful for many professional traders who also know when to get out of a position. Many investors also might not care what price they buy a security for because they think the extra money they pay is meaningless when you look at the long-range prospects of the company. The only time we use a market order is in an emergency.

WHEN WILL TRADES BE SETTLED?

This is one of those rules that is least understood by the public and yet has the most potential to profoundly affect the way Wall Street does business. At the present time, when you place a stock trade, you and the brokerage have 3 business days to settle the trade. It's called T + 3. This means you have 3 days to come up with the cash to pay for the securities, and the brokerage has 3 days to arrange with the clearing firm to provide you with the securities.

When you place a trade after hours, at least until 8:00 p.m., it's designated as a day order, or treated as if it were placed that day. In other words, you still have 3 days to pay for the security. After 8:00 p.m., however, it gets a little confusing. The securities industry has proposed that orders placed after 8:00 p.m. be designated as next-day orders, meaning you will likely have a fourth day to pay for the security. The reason for this is simple: After 8:00 p.m., the brokerages claim there is not enough time for the back-office computer systems to process the trade in time for a T + 3 settlement date.

Adding to the confusion, there is a movement by many in the industry to move to a T + 1 settlement date, meaning that cash and securities would be settled the day after a trade. Once

again, it involves reprogramming computers and modernizing back-office procedures. The good news is that many of the major market participants have already anticipated these future changes and have taken steps to improve efficiency and order processing. For investors, it means that you'll have less time to pay for your securities. As it stands now, under T + 3, you could buy and sell a security for a profit before you even have the money to pay for it. Before you get the wrong idea, there are strict procedures to prevent people from misusing this 3-day credit. To be safe, it is always a good idea to buy and sell securities with available cash.

We think that the securities firms will eventually reprogram their computers and solve the problems with back-office procedures. Many years ago, before computers infiltrated the brokerage houses, the stock markets occasionally closed on Wednesday afternoons so the back office of the brokerage firms could catch up with all the paperwork. We always wondered what stockbrokers did while the back office caught up on paperwork. Golf, anyone?

However, as technology improves and computers process orders faster and more efficiently, a T + 1 or T + 0 settlement date is likely in the future. This means that you actually have to come up with the cash before you can place a trade. It also means that the transfer of stock and money will one day be instantaneous. It is still going to take a couple of years, but that day is coming.

WILL STOCK SPLITS AND DIVIDENDS BE ALLOWED AFTER HOURS?

Many online traders have known for a long time that it is possible to profit on the news that a stock might split. For example, a 2-for-1 stock split means that the price of the stock is cut in half while the numbers of shares available for trading is doubled. So, for instance, if Yahoo! was at $300 a share and a 2-for-1 stock split was announced, the price of the stock would be cut in half to $150 a share. If you owned 100 shares, even though the stock is now valued at $150 a share, the number of shares you owned would double to 200 shares.

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Although stock splits don't increase the net worth of the company or your holding, because you're increasing the number of shares available for trading in return for a lower price, it has the psychological effect of attracting more buyers who think the stock is affordable. In the minds of many investors, although they can't afford to buy 100 shares at $300, they think they can afford to buy 100 shares at $150.

The announcement of a stock split has been known to drive the price of many stocks up. In fact, people who try to profit on splits think that profits can be made when the news is first announced and after the split happens. There are no guarantees, however. For the after-hours trader, the news is more important than the actual split, but profiting from this controversial strategy can be extremely difficult. In fact, a number of investors avoid trading on splits because it is hard to predict what the stock will do.

A 4:00 p.m. EST stock-split announcement could impact the price of the stock, although it is possible that trading on the stock will be temporarily suspended while the news is disseminated. Keep in mind, however, that the actual stock split will occur first in the regular market hours.

Dividends are handled almost like stock splits. The announcement of a dividend, which indicates the company has shifted its revenue distribution and growth strategy, could push the stock higher. The announcement of a dividend could give savvy traders an opportunity to trade on the information.

Stock splits and dividends will continue to occur during the regular market as they always have. There is no advantage for a company to let after-hours traders have the first opportunity to buy a stock after a split or dividend.

WHAT WILL HAPPEN TO MARKET MAKERS AND SPECIALISTS?

Market makers on the Nasdaq and specialists on the NYSE put up their own capital to provide liquidity in the market and ensure that every trade is two-sided. In other words, if you want

to buy a stock and no sellers are available, the market makers or specialists may risk their capital to buy the stock. Their profit comes from the spread, or the difference between the best bid and best ask price.

In the after-hours market, participation by the market makers is voluntary. They can take the other side of a trade if they want to, but they are not required to as they are in the regular market. This, of course, could change as the Nasdaq and the NYSE join the after-hours market and require market makers and specialists to participate.

Because of the proliferation of ECNs, which automatically match buy and sell orders, the go-betweens have slowly seen their profits dwindle over the years. In the after-hours market, it hasn't been liquid enough for market makers to stay late. The ECNs are currently handling the majority of after-hours orders without the help of market makers or specialists, with the exception of the Chicago Stock Exchange, where the market makers voluntarily agreed to stay until the after-hours market closed. This trend is likely to continue, that is, more toward an electronic platform and less toward physically handling the orders.

As the Nasdaq and the NYSE get officially involved in after-hours trading, nearly everyone agrees that the role of the market maker and specialist will change. There is some disagreement on what that role might be. Some believe that if the liquidity in the after-hours market increases and there are profits to be made, the middlemen will join in, either as volunteers or as required by rules, and ensure there is a two-sided market, a buyer and seller. This means that if you place an order, you know there will always be someone on the other side ready to trade with you. When there are no individual buyers and sellers, which often happens with some stocks, especially small-cap stocks, the market makers and specialists are willing to commit their own capital in order to make an orderly and fluid market. This is the essential role that market makers and specialists play during the regular market, which is currently absent in the after-hours market. If they do decide to participate, there will be increased liquidity, reducing the volatility on some stocks.

Others believe, however, that the role of the market maker and specialist will slowly be diminished, if not eliminated.

Since it is cost-effective to have orders matched electronically between buyers and sellers, and since liquidity will continue to grow after hours, in the future there will be little need for middlemen. In other words, if there are enough buyers and sellers, the computer will automatically take the other side of a transaction. Once people realize it is cheaper and faster to do trades through an ECN than a market maker, some people believe the middlemen won't be necessary, at least for retail investors.

No matter what you think will happen to middlemen, nearly everyone agrees that their function will change, and not just during the after-hours session. As spreads continue to narrow during the regular and after-hours market, especially because of decimalization, it will harder for market makers and specialists to make profits on the spread. There are, however, other ways for them to make money, and it is likely the market makers and specialists will find ways. Keep in mind that a number of market maker firms have invested in ECNs, perhaps anticipating how the role of the middleman will change.

WILL THERE BE A 4-DAY WEEK?

Although the online brokerages, in conjunction with the ECNs, can operate 24-hours a day, some in the industry have proposed that after-hours trading be limited to only 4 days, Monday through Thursday. They want to exclude Friday because they believe that trading will be lighter than usual on Fridays, so it isn't worth the extra expense to hire additional staff and keep the computers running if no one will be trading. In the end, it is you who will determine if Friday will open for trading. For what it's worth, a number of ECNs are open on Fridays and will remain open unless ordered to close, which is unlikely.

There is also some talk about suspending after-hours trading on the third Friday of each month, or options expiration day. On this day, all the option contracts expire, which always causes wilder price swings in the regular market. The feeling by many is that options expiration days are volatile enough without adding extended hours. When you add the volatility of options expiration to an illiquid after-hours market, anything could happen.

For risk-loving traders who thrive on wild price swings to make money, this is a perfect opportunity. Until the industry agrees upon a standard set of rules, however, you have to check with your online broker to determine if the ECNs it routes orders to allow trading on Fridays.

CAN I BUY AN IPO DURING THE AFTER-HOURS SESSION?

If you thought that options expiration day was wild, imagine what would happen if initial public offerings (IPOs) were allowed to open during the after-hours market. If allowed, the prices of successful IPOs would probably skyrocket in extended-hours trading and then continue on into the regular session. A savvy stock promoter could really create an online buzz by opening an IPO during the after-hours market. If the strategy were successful, the IPO would be dozens of points higher by the opening of the regular market.

We hate to poke a hole in this dream, but it's not likely to happen. Just like splits and dividends, we don't think the securities industry will allow IPOs to open during the after-hours session. You could, however, profit from an IPO by trading it that night, after it opens during the day. If the IPO is still going strong into the after-hours market, although a risky strategy, you could try to latch onto the momentum.

HOW MANY SHARES CAN I TRADE AT ONE TIME?

In the early days of retail after-hours trading, some of the ECNs limited the number of shares you could buy at one time to no more than 5,000 or 10,000 shares. This rule was designed to prevent a large institutional investor or wealthy individual from taking a large position on a stock, causing a wild price swing on a thinly traded stock. During the regular market, where volume is

high and liquid, an order of 100,000 shares or more would hardly get noticed in most major stocks, but in the after-hours market, it could have a huge effect.

Once again, as volume and liquidity increase, these limits will be lifted. Institutional investors have always been free to buy an unlimited amount of shares. In fact, one of the advantages of using Instinet to place trades is that you can quickly and anonymously place large orders. Over time we believe the share limits will be lifted for retail investors and you will be able to trade an unlimited amount of shares (as long as you have sufficient account equity) at night on the online brokerage of your choice.

WHAT STOCKS CAN I TRADE AT NIGHT?

If there is any rule that is changing the most, it is the one that limits which securities are allowed to be traded in the after-hours market. This is one of the main reasons many people initially were confused by after-hours trading. They simply didn't know which securities were available for trading. Compounding the confusion, each ECN had a different set of rules. In the early days, although all Nasdaq stocks were eligible for trading, many online brokerages and exchanges limited the number of stocks for trading to only the most actively traded Nasdaq stocks. For example, the Chicago Stock Exchange, the first exchange that allowed extended-hours trading, limited the number of stocks it would trade to only 300.

At first, the other major market participants were hesitant to allow all Nasdaq stocks because they were afraid that thinly traded stocks in an illiquid market could cause wild price swings and other irrational conditions. As a result, many investors stayed away from after-hours trading because they wanted to wait until all stocks were eligible for trading.

What about trading the NYSE stocks, the prized blue-chip stocks like IBM and GE? As you know, at first, because of a number of anticompetitive rules, like Rule 390, NYSE stocks were not allowed to be traded on any exchange except the NYSE. Rule 390, which was rescinded late in 1999, specified which stocks

could be traded in alternative markets. This rule barred the Nasdaq Stock Market and ECNs from trading the stocks of companies listed on the NYSE before 1979, including IBM and most of the Dow 30 stocks.

For example, when Lucent (LU) dropped by 18 percent in after-hours trading one evening, only the customers of Instinet and MarketXT were allowed to make trades in this stock. Because of the repeal of Rule 390, all the NYSE stocks will be available for trading on any exchange at any hour. It will also allow the Nasdaq and the NYSE to trade each other's stocks, unheard of just a short time before. And, as noted earlier, the merger of Archipelago and the Pacific Stock Exchange will allow after-hours trading of NYSE and Nasdaq stocks.

Once all the NYSE and Nasdaq stocks are allowed to be traded, and as soon as the after-hours market begins to resemble the regular market, the confusion will disappear. In the future, when news about a stock is announced, you won't have to think about whether or not the security was allowed for trading by your ECN or broker. As the confusion over after-hours trading goes away, more individual investors will likely join in, creating more liquidity and eliminating many of the initial concerns of the after-hours market.

HOW WILL AFTER-HOURS TRADING AFFECT INSTITUTIONAL INVESTORS?

You might wonder what institutional investors are thinking about the sudden interest in after-hours trading, which has been their sole turf for so many years. At first, many viewed the increased activity of after-hours trading with mild amusement. The idea that retail investors could jump into the after-hours market and actually make a profit seemed impossible only a few years before. We doubt they're laughing now.

As you may know, before the great bull market of the 1990s which made most institutions look good, approximately 91 percent of the fund managers couldn't beat the S&P 500 in any given year. This led to a mad rush to index funds, particularly the Van-

guard 500 S&P Index fund. It didn't take long for members of the public to discover that they could compete quite nicely against many of the institutional investors by investing in index funds.

The after-hours market is just another opportunity for the retail investor to compete with institutional investors. For now, it is doubtful there will be enough activity by individuals to have much of an impact on institutional portfolios. Many institutional investors, which have enjoyed tremendous trading advantages in the after-hours market, don't necessarily welcome the competition from retail investors, especially on breaking news. Perhaps that is one of the reasons some major institutions have lobbied for a 1-hour pause in the market to allow institutions to process their orders and catch up on paperwork. It would also give them a head start on any breaking news announcements.

As far as many pros are concerned, the only way you'll be able to win on Wall Street is to invest with them. Since you can't beat us, then join us. Although some would agree with this line of thinking, you wouldn't be reading this book unless you thought you could beat the pros at their own game.

It is true that you should be a bit wary about mixing it up with institutional investors. James Cramer, CEO of TheStreet.com, warned that many pros are waiting for uninformed retail investors to appear in the after-hours market. He was quoted in *Time* magazine: "The professional sharpshooters are always looking for some fresh after-hours blood. They await your arrival. Don't say I didn't warn you." If you trade in the after-hours market without taking the time to learn what is involved, it could be an unprofitable experience. We do think our book gives you the knowledge you need to be a profitable trader, no matter whom you're competing against.

HOW ARE YOU GOING TO BE EDUCATED ON AFTER-HOURS TRADING?

One of the concerns of the SEC and most major market participants is that retail investors must be informed of the rules and risks of after-hours trading. In fact, in the early days of after-

hours trading, the media concentrated more on the risks of after-hours trading than on the benefits. Perhaps everyone felt the benefits would take care of themselves, but individual investors needed guidance on the risks.

This is likely one of the reasons the after-hours market started slowly. But like any good idea, especially an idea that can help people make money, the public began to embrace it. You can probably credit CNBC for initially highlighting the after-hours trading activity. Once it started covering the action after 4:00 p.m., interest in after-hours trading picked up immensely. CNNfn and *Bloomberg Moneycast* also began to cover trading activity before the premarket opening at 8:00 a.m. EST.

The online brokerages take great pains to let the retail investor know the after-hours market is not the same as the regular market. They display a lengthy disclosure statement listing all the possible risks of after-hours trading including liquidity, wild price swings, and fragmentation. This was primarily designed to placate the SEC, which is diligent about making sure retail investors know what they are getting into. You can trade if you want to, the disclaimers imply, but don't tell us we didn't warn you.

No wonder people were scared off from after-hours trading during the first couple of months after reading the lengthy disclosure statements, which resembled leases rather than trading agreements. The major market participants did a good job of informing the public of the risks, although the benefits of after-hours trading were generally ignored. It was up to the after-hours critics to inform the public, and they did, via dozens of newspaper and magazine articles, concluding that after-hours trading was too dangerous for retail investors.

An extensive educational campaign was started, and the major market participants dutifully posted after-hours updates, rules, and other information on their respective web sites. The NASD, SEC, NYSE, and Nasdaq also posted up-to-date information on developments. At first, there was little coordination among the major market participants. Eventually, all the major market participants realized their survival depended on educating consumers. After all, if the retail investor didn't show up to trade, then after-hours trading would fail. Very few of the major market participants wanted that to happen.

The educational campaign is mostly conducted through the Internet, and anyone looking for information on after-hours trading should look online for up-to-date information. In the Appendix, we include information on web sites and the addresses of the major players. Many web sites contain extensive extended-hours news, quotes, and analysis. In addition, all the major market participants, including every ECN as well as the Nasdaq Stock Market and the NYSE, have extensive information on after-hours trading.

HOW WILL INTERNATIONAL INVESTORS AFFECT THE AFTER-HOURS MARKET?

International investors have always paid close attention to the U.S. market. Many people already recognize that the stock market is a global market. Sophisticated investors who are aware of this have made tremendous profits using the Dow as a barometer to what the international markets might do. As Japan climbs out of its 8-year recession and other international investors have woken up to the idea that there is money to be made in the stock market, the financial world will not be the same.

Already, a number of online brokerages are rapidly expanding to other countries, allowing international investors to participate in our stock market. E*Trade, for example, is opening up branch offices across the world, with many online brokerages to follow. The added influx of international traders eager to invest in our market will likely increase liquidity in the after-hours market.

In another interesting development, Brazil was the first stock market in South America to offer extended-hours trading. This was seen as a way to improve business and compete with the United States for market share. Similar to what is happening in Brazil, electronic trading has been on the rise in other countries as well, and extending hours is a natural way of meeting the needs of these up-and-coming traders.

As we mentioned at the beginning of this book, European investors have discovered the stock market. Some of our international college friends, as soon as they receive their loan checks

from their government, use it to trade stocks. Although they often break a number of sound money management rules, we admit that some have been quite successful. It might seem crazy to think that someone might want to wake up at 3:00 a.m. to trade U.S. stocks, but it's not crazy when it's 9:00 a.m. in Sweden or 9:00 p.m. in Hawaii. A 24-hour trading day will make it easy for international investors to participate in our market.

As many European countries transform from a post-cold war socialist society toward capitalism, millions of Europeans, especially those who grew up with the Internet, are realizing that there are enormous financial rewards to investing in the U.S. stock market. This is a new generation of Europeans, prepared to adapt to a world based on computer technology, hungry for information and profitable financial opportunities.

WHAT'S GOING TO HAPPEN TO STOCKBROKERS?

You might wonder how the after-hours market is going to affect one of the oldest and most revered traditions on Wall Street, your friendly neighborhood stockbroker, or financial consultant, as many like to be called. The main purpose of a full-service broker is to give professional investment advice and guidance and profitable stock recommendations based on the client's risk tolerance and financial objectives.

In the old days, when you placed an order with a broker, you had little control over how much you paid. The broker put your order in, likely at the market price unless you gave other instructions, and you'd pay the $200 or more for the privilege. Everyone got a cut of your money, including the broker, the market maker or specialist, and of course the brokerage firm. If you were lucky, you made more on the stock than you paid in commissions. No wonder it made sense to adopt a long-term buy-and-hold strategy. It definitely wasn't easy to be a short-term trader.

The emergence of online trading has already upset the delicate power structure that has existed on Wall Street for so many years. Therefore, it is understandable why so many brokers are

worried about their future. The proliferation of online brokers has already put a huge dent in the business of traditional brokers. The major Wall Street firms have been monitoring the rapidly changing environment, trying to anticipate their future. Many were taken by surprise as investors dismissed traditional methods and flocked to the Internet to place their trades.

Although discount brokers were bad for business, after-hours trading in and of itself will have little effect on the full-service brokerage industry. No matter what the exchange or trading network, the full-service broker still has the same purpose. There will always be a need for competent and honest financial consultants to give advice to customers on stocks to buy and inform them of changing financial conditions. Of course, millions of people have discovered the research capabilities of the Internet, but not everyone has the time to sift through the information. There will always be wealthy, high-net-worth individuals who need others to manage their money and to give sound advice.

So it is unlikely that stockbrokers are going away; rather, they will continue to place trades and consult with clients on all aspects of their financial condition. As Wall Street goes through even more profound changes, some brokers might feel the pinch. For example, some have even predicted that future broker commissions could be reduced by as much as 50 percent.

With after-hours trading, it is doubtful many brokers will stay until 8:00 p.m. to process orders or give advice to clients, but their customers won't care. Stockbrokers can still recommend stocks to buy or sell. If clients want to place an order so badly after the market closes, they can do it themselves. This is just one example of how the role of the broker is changing along with the other breathtaking changes on Wall Street.

WHAT ABOUT THE PRE-OPEN?

Although we talked a lot about after hours, you should not forget the pre-open market, from approximately 6:00 a.m. until the market opens at 9:30 a.m. The pros have had access to the pre-

open market for years, primarily through Instinet. However, most of the ECNs do allow retail investors to trade stocks before the market opens, and the hours are expected to expand.

There are many opportunities for retail investors to make money before the market opens. If you know that a company got hit with a surge of late-night selling orders, you might think about placing a morning trade to take advantage of institutional panic selling. Yes, institutions do make mistakes—in fact, they make lots of them. A good example is what happened to Xerox (XRX) Corporation. It announced at 4:00 p.m. that it would miss analysts' expectations by over 40 percent because of Y2K concerns and a slowdown in international orders. Although Xerox was still making profits, it would not be as strong as analysts expected. In the after-hours market, institutional investors frantically sold their shares, and Xerox plummeted in price, dropping from $24 a share to as low as 19⅞ a share, a drop of almost 20 percent.

The next morning, however, in pre-open market activity, the stock staged a small comeback. Other institutional investors, especially value investors, smelling a bargain, scooped up Xerox at $20 a share. When the market opened that morning, many retail investors followed, pushing Xerox up to over $22 a share.

WHAT WILL FUTURE STOCK MARKETS LOOK LIKE?

If we knew that, we probably wouldn't have to work for a living. Seriously, we do have some clues about the future of the stock market. First, we believe there will definitely be a 24-hour global market which will have links to all the world markets and which will allow you to trade any time of the day or night. This will include free and immediate quotes and the ability to check your account balances at any time.

All you have to do is look at the European stock markets to see where the U.S. markets will be in a few years. The European markets are completely electronic, matching buyers and sellers electronically without the use of floor brokers. If this trend continues, the system we call "open outcry," where traders yell and

make hand signals, will likely be reduced, perhaps eliminated. Still, traditions are hard to break. It will be a long time before professional traders on the exchanges turn in their paper order books and shift to a fully electronic market, but eventually they will.

Nevertheless, the market of the future will be heavily dependent on technology and less dependent on human interaction. Take a look at the 3-D virtual games that many teenagers play to glimpse how you might interact with the stock market. Imagine trading stocks on the floor of an exchange from the comfort of your very own home. As technology improves, we will look back at the relatively simple and static web-based screens and chuckle. It doesn't take a lot of imagination to realize that trading in the future will be a virtual 3-D experience that will allow you to intimately experience what it's like to be on the trading floor. Add in the ability to trade stocks anywhere at any time and you have an idea of what trading might look like in the future. We believe that, technologically speaking, we have only scratched the surface.

IT'S TIME TO TRADE

If we have done our job, you are seriously thinking about opening up an after-hours account. If you are a relatively inexperienced investor, spend as much time as you need to study how stocks behave in the after-hours market. Once you feel comfortable in this new trading environment, then you can start making trades, but we recommend that you start small, with no more than 100 share lots. If you are an experienced trader or want to learn more about sophisticated trading strategies, the next chapter should meet your needs.

9

ADVANCED TRADING STRATEGIES FOR THE AFTER-HOURS MARKET

Up to now, we have primarily given you a nuts-and-bolts explanation of after-hours trading, generally geared to the retail investor or short-term trader who is entering the after-hours market for the first time. We've warned you of the risks of after-hours trading, including extreme price fluctuations, wide spreads, and fragmentation. For most retail investors, these conditions can be extremely dangerous, and that is why we've spent the time to explain the risks.

In this chapter, however, we are going to break all the rules. We will show you how to turn the possible risks we outlined above into profitable opportunities. This chapter is geared toward the experienced after-hours trader or knowledgeable short-term trader who is willing to engage in aggressive tactics to make money in the market, primarily based on technical analysis. An unpredictable after-hours market with wild price swings and wide spreads is ideal for the professional trader who thrives on extreme conditions to make profits.

So if you are new to trading, we strongly urge you to get your feet wet with basic strategies *before* trying out any of the tactics included in this chapter. To make money as a professional night trader, you need to be faster and more knowledgeable than

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everyone else. Most important, you need to be right. The statistics indicate that most short-term traders will lose money. Add in an illiquid after-hours market and even fewer will be successful. Nevertheless, if this is the kind of trader you are, then this is the chapter for you. Now that we've got the disclaimers out of the way, let's take a look at strategies that are destined to make your heart skip a few beats.

PAY CLOSE ATTENTION TO THE SHARE SIZE OF EACH LIVE ORDER

After-hours traders often overlook the importance of order size. The size of each order represented in the limit order book can be very helpful in determining what the "big money" is doing to the stock. "Big money" is a term that is commonly used to refer to traders who buy and sell very large quantities of stock on a regular basis. These people consist of institutional traders, such as mutual fund managers, large retail investors, and floor traders.

When we first started trading, we couldn't care less whether institutions were trading the stocks or if it was the small-time day trader. We really didn't think it made much of a difference in the performance of the stock. However, as we began to pay more attention to price movements of stocks based on order sizes, we started to realize that it really does matter who is doing the buying and selling of individual stocks. Why? Big money typically can influence the near-term direction of the stock. As a result, we learned that it is quite important to observe the size of both the buy and sell orders that are live in the limit order book.

Although there are no arbitrary numbers that can be used to determine if the share size being bought or sold is big money or just your average investor, common sense prevails. For example, if you are looking at a $50 stock and the average order size is only 100 shares, it is likely that the interest being shown is primarily from average investors as opposed to big money interest. However, if you are looking at a $50 stock and the average order size is 5,000 shares, those are not likely to be the average investor's

orders. Instead, those are more likely to be either institutional orders or those of experienced day traders who have large amounts of capital.

The exact size of each buy and sell order is not what you are looking at, however. Rather, you want to look at the difference between the size of the average buy order and the size of the average sell order. This can be done either by estimating or by adding up the total number of shares displayed on the buy or sell side and dividing by the total number of individual orders that you see.

If the size of the average sell order is much higher than the size of the average buy order, this indicates that there may be more near-term selling pressure than buying pressure. This would be one factor that would encourage us to sell the stock short. If the size of the average buy order is much larger than the size of the average sell order, then the opposite is true and we would think about going long. Obviously, this is not the only factor to consider, but it is one type of analysis we do on the limit order book.

Let's look at Figure 9-1, which shows a screen shot of NOVL in the Island order book, to illustrate how you can determine order size. If you calculate the average order size for the first 15 orders on both the buy side and the sell side, here is what you will come up with: 250 shares is the size of the average buy order, and 566 shares is the size of the average sell order. Although both of these average order sizes are relatively small, you can see that the size of the average sell order is more than twice as large as the average buy order. Again, this does not automatically indicate that the stock is going to sell off. Rather, it is merely one piece of information that you can use to help assess a stock in the limit order book.

It is also helpful to look at the bottom of the limit order book where it displays the number of live buy and sell orders, even beyond the 15 that you see. In this case, there are 15 more buy orders and 8 more sell orders in the book. In this instance, it is relatively balanced, but sometimes you will see a much larger quantity of one or the other. When that happens, you can sometimes use this information as another type of indicator for buying or selling interest in the stock.

FIGURE 9-1 *Island book—Novell stock*

island home system stats help

NOVL

GET STOCK

NOVL go

LAST MATCH		TODAY'S ACTIVITY	
Price	37 15/16	Orders	16,074
Time	19:38:55	Volume	3,382,050

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
500	36 1/2	4,950	37 15/16
100	35	1,000	38
100	35	145	38 1/2
50	34 1/2	200	38 5/8
30	34 1/16	200	38 15/16
500	34	180	39
500	34	100	39
75	33 1/32	500	39 5/16
500	33	300	40
340	33	500	40
200	31 1/4	170	40 1/4
200	31	20	40 1/2
400	31	54	40 1/2
150	30 15/16	50	41 1/2
100	30	125	42
(15 more)		(8 more)	

As of 20:00:42

KNOW THE NUMBER OF INDIVIDUAL ORDERS AT EACH PRICE LEVEL

Even more important than the size of individual buy and sell orders is the actual quantity of separate orders found at each different price level. Sometimes, you will only see one order at each price level, but other times you will see a large number of separate orders at a particular price on either the buy or sell side.

A common feature of many limit order books is that similar price levels are grouped together by color. The colors themselves don't mean much; they merely indicate a group of orders that are all at the same particular price. This color coding makes it easier to quickly identify a group of orders at the same price level.

By noticing a large quantity of orders at a particular price level, you can often find the technical support and resistance levels of a stock. For example, if you see a large number of separate buy orders at a price of $86 on a stock, then there is a good chance that the stock will bounce higher off that price, assuming, of course, that it drops to that price. This could be considered a temporary support level because those buy orders typically would draw in other buyers. In a situation like that, we would usually consider placing an order about ¹⁄₁₆ above $86 to help ensure that we get our order filled before all those other orders.

If the situation is reversed, and there is a large quantity of sell orders at a price of $94, the same principle would apply. If we are trying to sell our position near that price, we would typically place an order just slightly below $94 so that we are more likely to get our sell order filled before anyone else. If the stock is rising on low volume, it is quite probable that the stock will hit the resistance level of $94 and quickly drop below it. The objective is to get filled before the drop occurs.

Another common phenomenon you'll frequently see is a large number of buy or sell orders at the nearest whole number. Although we are not certain why this occurs, we believe it's because people want to keep the math simple, so they put orders out there at the nearest whole number. This is just something you should be aware of, because it can help you to notice that resistance and support often occur at or near the nearest whole number.

Now, let's look at Figure 9-2, which shows a screen shot of Microsoft (MSFT) in the Island order book. Looking at the prices on the buy side of the book, you will notice that there is a maximum of only two to three individual orders at any specific price level. Based on the limit order book alone, there does not appear to be much technical support at any price level at or above $112. However, on the sell side, notice that the sell orders line up at $120. There are a total of 10 sell orders at that price, which

means that the stock may have a tough time breaking past the price of $120. But bear in mind that the more volume there is, the more likely the stock will eventually break through $120. And since there are 10 sellers at $120 on the Island book, the odds are good that there are also a large number of sellers at the same price on other ECNs. In addition, the presence of a lot of sellers at $120 is also likely to draw in other sellers.

In this particular example, the only price level with a large number of sell orders is $120. However, another variation you will sometimes see is three or four sell orders of the same price on one side, but only one buy order at each price on the other side. This can be easily identified by the thickness of the color bands. The thicker the color bands are on the buy or sell side, the more orders there are at the same price levels. Again, knowing the number of orders being placed at a particular price level is not the only reason to buy or sell a stock after hours, but it is one more factor to aid in your analysis.

ANALYZE THE DIFFERENCE BETWEEN EACH PRICE LEVEL

When using the limit order book, another way to help judge the amount of buying or selling pressure with a particular stock is to observe the difference between each price level on the buy or sell side. One possible scenario is that you will see a very small price difference between each order on either the buy or sell side.

For example, on the buy side, you may see a best bid of 47¾, with the next best bid being 47¼ and the next highest bid being $47. That would represent a total of three different price levels of orders, but they are all within ¾ of each other. Combined with technical analysis, this could indicate a strong amount of buying interest, especially if there are a lot of individual orders at each of those price levels. The reason the prices are so close together is that people are very interested in buying the stock and are willing to pay close to the best bid price. If there weren't so many buyers, the bid prices would generally be spread farther apart. This would indicate that people are willing to let the price of the stock fall to them, as opposed to buying the stock at or near its current price.

FIGURE 9-2 *Island book—Microsoft stock*

island home system stats help

MSFT

GET STOCK

MSFT go

LAST MATCH		TODAY'S ACTIVITY	
Price	117 5/8	Orders	6,592
Time	19:55:03	Volume	644,292

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
200	117 3/8	100	119 1/8
146	117 1/8	470	119 3/4
45	117	100	119 7/8
30	117	50	120
50	116	100	120
100	116	10	120
17	116	53	120
120	115 17/32	72	120
100	115 1/8	19	120
30	115	30	120
100	115	50	120
25	115	100	120
100	114 1/16	100	120
50	113	70	120 1/4
44	112	30	121
(65 more)		(31 more)	

As of 20:00:42

The same thing is also true on the sell side. If lots of sell orders are grouped together at prices that are all relatively close to each other, this could likely indicate that people are anxious to get out of the stock. Sellers who are trying to get filled at prices near the current price offer will often drop their offer prices lower in an attempt to get filled. Frequently, this will cause other sellers to do the same, creating an avalanche of selling. This is a great scenario if you are short the stock.

The other possibility is that the prices of the buy and sell orders may be farther apart. For example, you may have one person bidding a price of $78 for a stock, but the next highest bid is

only $75, followed by a bid of $73, then a bid of 71½. When there are large gaps between price levels on the buy side, this can be an indicator that people are expecting the price of the stock to drop much lower than its current price, and thus they put out a lower buy price.

The reverse is also true on the sell side. If the gaps are farther apart in pricing, this may be an indicator that many people are expecting the price of the stock to rise much farther, and that is why they have their sell orders placed at prices much higher than the current offer price.

The key here is not only to look at the difference between each price level on the buy or sell side, but, more importantly, to compare the gaps on the buy side with those on the sell side. If the prices are much closer together on the buy side than they are on the sell side, this could be an indicator that there is more buying interest than selling interest, and people are trying to drive the price of the stock higher.

Remember that this cannot be the only factor in deciding whether or not to initiate a position in a stock. This strategy must be combined with the others described in this section of the book.

OBSERVE THE PRICE AT WHICH ORDERS ARE BEING EXECUTED

One common and very simple technique you can use to help identify the after-hours strength of a stock using the limit order book is to simply observe whether the stock is trading more on the bid price or the offer price.

During normal market hours, if the majority of trades are being filled at the offer price, this typically indicates buying pressure since traders characteristically buy stocks at the offer price. If, on the other hand, lots of trades are coming across at the bid price, this is typically an indication of selling pressure, since sellers will usually sell at the bid price. The same thing holds true after hours and premarket.

Limit order books generally show you the price of the last trade, along with the time the order was executed. The price of

the last trade is the one you want to pay attention to. If the current best bid price is 65¼ and the current best offer price is 67½ on a particular ECN, then you know that the next order executed will definitely be executed at one of those two prices. Simply wait for the next order to be matched and then observe whether that order match was done at the bid or the offer price. If the stock is being heavily traded after hours, you will notice a trend—more orders being executed at the bid or offer price.

Once you have determined whether there seems to be a trend of more buying or more selling in the stock, you also want to notice how quickly traders either increase their bid price or lower their offer price. Typically, the greater the buying interest, the quicker that traders will increase their bid prices as the orders on the offer or sell side are being filled. Likewise, if a stock is weak, traders will typically decrease the prices of their sell orders as the bid orders are being filled.

Unfortunately, there is no magic formula for determining the strength or weakness of a stock based merely upon the prices at which orders are being executed. However, if you get into the habit of always observing whether orders are filled at the bid or offer price, it will serve as a guide that, when combined with the other tactics, will greatly assist you in your after-hours trading.

ALWAYS COMPARE THE PRICES WITH THOSE AT OTHER ECNs TO LOOK FOR CONFIRMATION

Due to fragmentation, a stock may actually be trading higher after hours on one ECN than on another. In other words, pricing for any given stock can be different on each ECN. Therefore, it is important to compare the limit order book you are using with the order books of other ECNs. The more ECNs that are showing similar pricing after hours, the more likely it is that you are making the right decision. If, however, the ECN you are watching is showing totally different pricing action than the rest of the ECNs, be wary. The stock may not be as strong or weak as you think it is.

At this time, we are not aware of any web site or software that combines the limit order books of all the various ECNs into a single, all-inclusive source—a kind of super limit order book. The closest thing to this is a Nasdaq Level II screen; in addition, ISLD and ARCA don't show you all the individual orders of each ECN. Level II only shows you the total size of all the orders combined at the best bid and best offer price. As such, it is necessary to view all the ECNs' order books separately by either going to their respective web sites, which is time-consuming, or using software like CyberTrader or Executioner, which allows you to view any of the order books. Other trading software the pros use to view multiple order books include TradeCast, Real Tick III, REDIPlus, and Tradescape, but there are dozens more.

ARBITRAGE THE VARIOUS ECNS

Since the after-hours trading arena is changing so rapidly, it is difficult to know how long you will be able to arbitrage. However, until something happens that renders this technique ineffective, our advice is to take advantage of it while you can.

Loosely speaking, arbitrage is when a person purchases stocks on one market and immediately resells them on another market in order to profit from the price discrepancies. In this case, the stocks we are trading after hours are generally going to all belong to the same market (Nasdaq or NYSE). However, it is important to remember that each ECN is independent of the others. As a result, the prices of individual stocks vary from one ECN to another, making it possible to arbitrage the ECNs.

In order to be able to do this, you must open an account with a broker that has access to multiple ECNs. Typically, any of the day trading brokerage firms will fit this category. Obviously, the more ECNs that the firm subscribes to, the more choices you will have when arbitraging.

Once you are set up with the appropriate broker and access to multiple ECNs, it is as simple as either watching each ECN's respective order book or watching Nasdaq Level II quotes. The idea is to buy (or sell short) a stock on one ECN and then imme-

diately execute an order to sell (or cover) that stock on a different ECN, thereby realizing an immediate profit with minimized risk. Let's look at an example of how this might work.

Let's say that you have access to both Island and MarketXT at your brokerage firm. Because Apple Computer just announced some positive news after the close, you decide that there may be a sizable amount of after-hours volume on that stock. You enter the ticker symbol for Apple Computer (AAPL) into both of the ECNs' order books. On Island, you notice that the best bid for Apple is currently 500 shares bid at $95\frac{3}{8}$, while the best offer is currently 700 shares at $95\frac{15}{16}$. At the same time, you notice that MarketXT is showing a best bid of 1,000 shares at $96\frac{3}{16}$ and a best offer of 300 shares at $96\frac{9}{16}$. You immediately realize that you can make a quick profit of $\frac{1}{4}$ by simply buying the 700 shares offered on Island at the best offer price ($95\frac{15}{16}$) and selling on MarketXT at the best bid price ($96\frac{3}{16}$). After commissions, that would leave you with a profit of approximately $150. Not bad for a few seconds of work.

It is important to remember that this strategy involves immediate execution. If you are not quick, someone else will beat you to that trade you are trying to make. Therefore, it is crucial that you immediately execute the buy and sell orders when you see a possible arbitrage situation; otherwise someone that is faster than you will do it first.

BEWARE OF THE "GAP AND TRAP" IN PREMARKET TRADING

We have found that premarket trading can be extremely profitable. While investors have been able to trade on some ECNs as early as 6 a.m., the premarket is still relatively new. In our opinion, there are at least as many profitable trading opportunities with premarket trading as there are with after-hours trading, if you know what to look out for.

A classic strategy to guard against is called a "gap and trap." Simply put, a gap and trap occurs when market makers bid up the price of a Nasdaq stock in premarket trading so that the stock

opens higher than the price it closed at the previous day. However, as soon as the market opens, the market makers start dropping their bid prices quickly and sharply, which causes the price of the stock to drop rapidly below its opening price.

The trader who bought a stock at a higher price in the premarket is immediately looking at a loss, which can be quite significant at times. The advantage for the market maker is that he or she can sell the shares of stock at a higher price, only to buy them back at a lower price a short time later. It is called a gap and trap because the market makers gap up the price of the stock at the open, only to let that gap turn into a trap a short time later. Your options are to either get taken or learn how to detect this practice and stop it from happening to you.

When looking for the gap and trap, it is helpful to have Nasdaq Level II quotes, which show you more detail about the quoted stock price. Instead of seeing only the current bid and offer price, you can actually see the individual market makers who are bidding and offering at each different price level. By seeing how many individual market makers are at each price level, it helps to show where the buying or selling pressure is on the stock. Simply put, if there are more market makers at the best bid price than the best offer price, there is more buying pressure than selling pressure. The opposite is true if there are more market makers on the offer side than the bid side. Access to Nasdaq Level II quotes is available at virtually any day trading brokerage firm, as well as several of the web-based brokerage firms. Once you have access to seeing Level II quotes, you will be better able to identify and detect the gap and trap.

Even if you do have access to Level II quotes—and especially if you don't—there are a few things you should look for in order to quickly and easily identify a likely gap-and-trap situation.

The first warning sign of a possible gap and trap occurs when you see that the price of a Nasdaq stock has risen significantly but on very low volume. If a stock is rising in the premarket on low volume, it means that there are not a large number of buyers supporting the price of the stock at that time, and any upward price movement you see is likely to be short-lived. Therefore, all market makers need to do is to drop their bid price on a couple of large sell orders to quickly drop the price of the stock.

Low premarket volume cannot be defined by any specific number of shares traded. It all depends on what the individual stock's average daily volume is. Let's look at an example to help you differentiate between low and high premarket volume.

Suppose that, 45 minutes before the regular market opens, you are looking at a stock that is trading up 3 points from its previous day's closing price. The first thing you would do is look at how many shares have traded in the premarket session. You notice that the stock has traded approximately 200,000 shares so far. Next, you look at the average daily volume of the stock, and you notice that it is about 1 million shares. If you do the math and divide the premarket volume by the average daily volume, you will figure out that the stock has already traded 20 percent of its average daily volume before the market even opens.

Obviously, this would not be considered low premarket volume. On the contrary, this would be quite high premarket volume. If this happens, we would not be as concerned about a gap and trap because there truly are a large number of buyers that are supporting the upward price movement of the stock. However, if there were only 3,000 shares traded and that same stock was up 3 points in the premarket, we would be very cautious, because it is likely a gap and trap.

Much like the Island order book, a Level II screen separates different price levels by bands of color so that you can easily identify how many different orders (or market makers in this case) are present at each price level. If you observe that several market makers are driving the price of a stock up in the premarket, check to see whether several ECN orders are doing the same thing. If all you see is movement of the market makers and no buying interest in the ECNs, be very careful.

Be aware of the fact that market makers are not required to honor their quoted prices in the premarket hours. Often, they will display a bid price that is several points higher than the price at which the highest ECN is bidding. But remember that they do not have to honor that price. This is a very important point and worth repeating. The reason this is so important is because 30 seconds before the market officially opens, all the market makers that are bidding high prices on the stock can quickly drop their prices. Why would they do that? Because once

the market officially opens, they are then required to honor their posted bid and offer prices.

Likewise, it is important to look at ECNs for the best bid price, because ECNs are generally used by retail investors and traders, both of whom intend to buy a stock at the higher price at which they are bidding. The average retail investor is usually not going to bid a higher price on an ECN without intending to actually get the order filled and buy the stock. Therefore, orders represented on ECNs can generally be thought to represent true buying interest. Remember that any bid orders on an ECN will be honored in the premarket if someone matches up an order with that ECN. The important point is that you know the ECN orders are not generally going to quickly disappear as soon as the market opens, like many market makers' premarket orders frequently do.

It is okay to have market makers bidding up the price of a stock in the premarket, but make sure that at least one or two of the ECNs are also present at the best bid price. If the ECNs are present but are three price levels below the best bid price a market maker is displaying, you must assume that the current market bid price is equal to the price that the ECNs are bidding, not the price that the market maker is showing. Don't forget: Market makers are not required to honor any posted quotes until the market officially opens.

In summary, premarket trading offers a great opportunity to get in stocks at prices that are often better than what the average retail investor will pay. However, always be on the lookout for the two telltale signs of a gap and trap. If you see that a stock has gapped up on very low volume and there are no ECNs at the best bid price, then it is best either to stay away from that stock or to sell it short. Use these two guidelines to help keep you out of trouble in the premarket hours.

TRADE THE SPREADS ON EACH ECN

Earlier in this chapter, we mentioned the importance of paying attention to whether trades were being executed at the best bid or the best offer price. We mentioned that this was often an indicator of the possible near-term direction of the stock. When a lot of

orders are coming across at the bid price, the price is likely to drop. When many orders are being executed at the offer price, the price is likely to rise. However, if an equal number of orders are hitting both the bid and offer prices, the stock will often stay relatively stagnant throughout the remainder of the evening session, thereby giving you the opportunity to "scalp the spread."

Scalping the spread is when you buy a stock at the current bid price and immediately place an order to sell the stock at a higher offer or ask price. If your order gets filled at the offer price, you just made a profit by scalping the spread of the stock. With this method, you are, in essence, acting like a market maker or specialist by profiting on the spread between the bid and the offer price. Although this method can be relatively simple and profitable, there are a couple of things we need to tell you about utilizing this type of trading.

First of all, you need to realize that this method usually requires you to purchase a large number of shares in order to realize a decent profit. This is because the spread is typically not very large. For example, if the bid price on a stock is 56⅛ and the ask price is 56⅜, that means you have a spread of ¼. If you only buy and sell 100 shares, you will make a gross profit of $25. However, once you subtract commissions out of that figure, you basically break even. Breaking even is certainly not worth the effort to even attempt this type of trading. On the other hand, if you were trading 1,000 shares at a time, you would make a gross profit of about $250 by scalping the spread. After commissions, you are still left with over $200 net profit for that one trade. So if you do not have enough equity to buy the necessary amount of shares required in order to make a profit by scalping the spread, it is probably best if you do not attempt this method of trading at all.

Another factor to consider when trading this way is the size of the spread—the spread needs to be somewhat large in order to have the best chance for profit. If the spread is only ⅛, it is going to be very difficult to make a profit on this stock due to the large number of shares required to be profitable. However, if a stock is trading after hours with a several-point spread, you are more likely to make a profit by scalping the spread. Even if your sell order does not get filled at the offer price, you can still lower your offer price closer to the bid price and make a profit on the spread.

Finally, if scalping the spread, you need to consider the fact that there can be significant risk involved if your sell order does not fill. Let's say that a stock is trading at $95 by 96⅞. You place your bid order at 95⅛, increasing the bid price by ⅛ and putting your buy order first in line. Someone sells to you at that price, and your order gets filled. You immediately place a sell order at 96⅞, but someone else then lowers the offer price to 96 9/16. You cancel your sell order and now chase the offer price down to 96 9/16 also. Meanwhile, the bid price drops to 94⅜. Now other traders have panicked and dropped the best offer price to 94⅞. As a result, you are looking at an immediate loss no matter whether you get filled at the bid or the offer price. This can happen very quickly and very easily. You must be prepared for this to happen and have a contingency plan in place. This contingency plan can be either to use a stop loss to get out of the stock once it trades below a specific price or to hold onto the stock for a longer period of time. Finally, keep in mind that successful scalping is extremely difficult in the regular market, and after hours the odds are even worse. It is estimated that after one year in the regular market, only a handful of scalpers make money. In the after-hours market, it's even harder.

LOOK FOR PROBABLE TREND REVERSALS ON WILD PRICE SWINGS

As we explained earlier, most companies wait until after the close of trading to make a major announcement, whether it is about earnings, a takeover, or a profit warning. In the not-too-distant past, only institutional traders had the ability to take advantage of trading these companies' stocks after hours and benefiting from the wild price swings. But as you already know, ECNs have changed all that. A majority of our readers are probably casual buy-and-hold investors that don't trade based on news announcements. However, if you are an after-hours short-term trader, you can execute quick trades that will allow you to profit from the volatility that always follows.

The first thing we want to make you aware of is that this technique is very advanced, and not for the faint of heart. This

technique is very fast, and one simple mistake can cause you to lose money. Furthermore, we strongly recommend that you begin using this technique by trading only a small number of shares. This will serve to reduce your risk if the trade is unsuccessful. However, as you get better at this technique, you will be able to gradually increase your share size, which will allow you to increase profits while minimizing your risk.

The principle behind this idea is that stocks often move rapidly both up and down immediately after major news announcements. This is because many investors and traders are buying and selling based purely on panic, although many of them aren't sure if Wall Street will interpret the news as being positive or negative. A good example of this is earnings reports. A company will frequently report a positive earnings report that beats expectations. It would be logical for the stock to move higher after the announcement, but many traders still panic and sell, thinking that Wall Street may interpret the news differently. After all the panic sellers sell their shares, the traders that think the selling was overdone will jump on the stock and start buying it, causing it to move higher. As a result, the stock will often seesaw up and down in a very wide price range because traders don't really know which way the stock should be going. This is the scenario that typically causes wild price swings in both directions within a short period of time.

You should be aware that it is nearly impossible to decide ahead of time which way the stock will go based purely upon the released news. Often a company will report what should be interpreted as positive news, but the stock declines. We have also seen several instances in which a company reports some sort of negative news, such as a profit warning, but the stock price increases. It is not a good idea to buy or sell short a stock based purely on news, because you could be wrong. Instead, wait to see how other people interpret the news, and which way they decide to make the stock go. Then, hop on the momentum and start trading the stock. The important point here is to never trade just on news, but wait for the momentum of the stock to reverse, and then trade it.

If you try to buy a stock while it is rapidly falling, or try to sell short a stock while it is accelerating higher, that is too dangerous and costly if you are wrong. If you do that just because you think the stock is going to find support (or resistance if shorting) at a certain price level, then you are asking for trouble. You

need to look for a variety of indicators that hint at an imminent trend reversal before ever attempting to profit from trading a wild price swing. Let's look at a real-life example of this.

After the close of trading on January 13, 2000, Intel Corporation (INTC) was scheduled to announce its earnings for the quarter. Since earnings reports typically come about 20 minutes after the market closes, we immediately pulled up the Island order book at the close of trading that day. The idea was to be able to watch the changes in price immediately after the earnings were announced. As of the official close of trading that day (4:00 p.m. EST), Intel closed at a price of 91¹⁄₁₆. As soon as earnings were announced, trading on the stock was halted in order to help settle some of the immediate volatility that often follows. Five minutes later, the stock opened for trading. Even though Intel blew away its earnings estimates, the stock quickly dropped to around $87 on the Island ECN. But the odd part is that after about 5 minutes of trading at $87 a share, the stock immediately reversed direction and started rocketing higher. In fact, not only did it accelerate back up to the closing price of 91¹⁄₁₆, but it also continued going higher, all the way up to $97.

A trader friend of ours actually bought Intel at just over $90 (on the way back up from $87), and sold it about 2 minutes later at a price of just over $94. What a quick way to make a 4-point profit! The next day, Intel opened at 98½, going as high as 106⅛ that day. That's a 19-point profit that could have been made by buying at the after-hours low and selling the next day at the high. Although this strategy might sound easy, it actually took a lot of analysis to be successful. Let's take a look at what our friend did—and didn't do.

Most important, our friend didn't buy the stock as soon as the earnings announcement was made. If he had speculated that the price was going to go up and had bought the stock as soon as the announcement was made, he would have ended up buying the stock around $90. But he might have panicked and sold the stock when it dropped to $87. Immediately after that, he would have been kicking himself because the stock turned around and blew past $90. What he did instead was to watch and wait like a cougar ready to pounce.

As the stock was selling off, the first clue the stock might rebound was that most of the sell orders driving the price down

were very small in size. If the average order size had been over 1,000 shares, that would have indicated that the big money was likely dumping it and the stock was likely to go even lower.

However, he also noticed that the average share size on the sell-off was very small, from 100 to 500 shares. This was a clue that the only people selling were the novice investors and traders. It indicates the novice sellers would soon go away, allowing the big money to step in and buy. In order to determine when the novices are through selling, you have to continuously watch the volume of the individual trades that go off on the bid side, since those are typically going to be the sellers.

Our friend also looked for an influx of buy orders coming in on the bid side. When the stock was selling off, there were only a few buy orders at each price level, and they were each relatively small in size. However, once the stock dropped to around $87, a large number of buyers came into the stock, which caused the stock to find some support at that price. It is important to understand not only that there was a large quantity of orders, but that each order was large in size, averaging 1,000 shares or more. Once these buy orders started coming in, the selling volume dried up, and the price of the stock quickly turned around and started to rise (see Figure 9-3).

In addition, those people who were shorting the stock started panicking and covering their positions, which helped to raise the price. It was at this point that our friend bought into the stock at a price around $90. Although he didn't get the best possible price of $87, he minimized his risk by waiting for the stock to show signs of a turnaround before buying it. If he had bought it as it was selling off, it would have been dangerous because the support level of the stock had not yet been reached. It could have kept on falling, which would have caused him to use his stop loss.

When he started to see a large number of decent-sized sell orders come into the stock, he sold into the rally and made an easy 4-point profit. Even though you could wait longer and make even more money, the important point to remember is to minimize your risk by waiting for the stock to reverse before buying it. Then, sell as it is still going up without waiting for it to come back down. Although large profits are great, we feel that minimizing your risk is even more important so you can stay in the game for the long term.

FIGURE 9-3 *Island book—Intel stock*

island home system stats help

INTC

GET STOCK: INTC go

LAST MATCH		TODAY'S ACTIVITY	
Price	93 3/4	Orders	13,802
Time	16:31:37	Volume	2,628,427

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
1,000	93 5/8	500	93 13/16
300	93 9/16	750	93 7/8
300	93 1/2	50	93 15/16
500	93 1/16	200	93 15/16
300	93	600	93 15/16
100	93	300	93 15/16
100	93	2,000	93 15/16
100	93	500	94
125	93	100	94
100	92 1/4	100	94
300	92 1/4	1,000	94
150	92 1/4	500	94
200	92 1/8	500	94
100	92	1,000	94
45	92	100	94
(111 more)		(86 more)	

As of 16:31:37

USE SECTOR TRADING AFTER HOURS

An overlooked but potentially profitable strategy is to do sector trading. Briefly, a sector is a group of stocks that are in the same industry, for example, the bank sector, the pharmaceutical sector, the technology sector, and the oil sector, to name only a few. In fact, every stock that is traded on either the Nasdaq or the NYSE belongs to a particular market sector.

You may have noticed that institutional money flow is constantly being shifted from one sector to another on a daily basis.

Although the technology and Internet sectors have been strong during the past several years, no one sector can be strong every day of the year. As Internet stocks drop in price, the institutional money in those stocks is rotated to other market sectors. When one sector goes down, another sector may go up. This is why you will often see days when the Internet stocks are down 5 percent, but the pharmaceutical sector may be up by that same 5 percent.

If you can learn to identify which sectors money is going into and out of on a daily basis, you can put your money into those same sectors. If you are looking for a place to start in order to learn what types of sectors to trade, as well as checking their daily performance, CBS Marketwatch (www.marketwatch.com) details all the various market sectors. Once you go to the site, click on "Market Data" (at the top of the page). This will bring up a list of various types of market data you can view. Once that page is loaded, click on "Industry Snapshots." This will take you to a page that lists all the major market indexes, along with the daily performance and ticker symbols of each sector. If you click on the name of the sector index, it will bring up a list of all the individual stocks within each sector. By using this web site, you can learn about the various sectors and view each sector's daily performance.

You will also notice that these trends often tend to run in periods of 3 days. Therefore, after a period of approximately 3 days of strength, we begin to look for a shift in money flow into a different sector. Once you are in the habit of monitoring sectors on a daily basis, you will begin to notice the relationships among them. This can help you significantly increase your trading profitability by taking advantage of all the market movements.

LEARN HOW TO SHORT-SELL STOCKS IN THE AFTER HOURS

Professional short-term traders like to tell people they can make money in both bull and bear markets. As long as the markets are volatile, and people are buying and selling, they can generate profits. In fact, one of the most effective methods of profiting during a market correction or bear market is to short stocks.

If you have been involved with trading for any length of time, you have likely heard of the benefits of selling stocks short. The concept is basically the same as buying a stock except the order is reversed. When you buy a stock, your objective is to buy at a low price and sell at a higher price to realize a profit. You typically buy a stock because you expect its price to go up. When you short-sell a stock, however, you are betting that the stock's price will go down rather than up. First you sell the stock and then you buy it back later, you hope at a lower price. You would typically sell short a stock only if you expect the price of the stock to drop. The ideal candidates for shorting are overhyped, poorly run businesses with stock prices that are dramatically higher than the value of the company. Finding these stocks is not as easy as you might think.

Shorting is generally considered to be more difficult and dangerous than going long because your loss can theoretically be unlimited. For example, if you spend $1,000 and buy 10 shares of a stock that costs $100 a share, the most money you could lose would be your initial investment of $1,000. That would only occur if the price of the stock dropped to $0, which is highly unlikely. But if you sell short 10 shares of a stock that is trading at $100, the stock could easily go up more than $100 per share, which would leave you with a loss greater than $1,000. How does this happen?

When you short-sell a stock, you are essentially borrowing shares from a broker. At some point you will have to buy the stock to replace the shares you borrowed. If you buy the shares back at a lower price than you sold them at, you make a profit. If you buy the shares back at a higher price than you sold them at, you incur a loss. Because you are eventually forced to buy the stock back, even if it is trading at $400 per share, you can lose much more than you initially invested. Be aware of these risks, and remember that in thin markets, sellers may be absent and it is easy for a stock to go up by huge percentages.

While shorting can be a significant opportunity for making profits, you must remember to cut your losses when the stock goes against you. We recommend that you allow no individual position to exceed more than 15 or 20 percent of your total account value. In addition, we advise you to always use a fairly tight stop loss when entering any position.

Since the after-hours market is so unpredictable, stocks can run up seemingly without reason after the market closes. Eventually, many stocks fall victim to profit taking and will drop at some point. When this happens, you can find some unique shorting opportunities.

The rules on selling stocks short after hours are different than in the regular market. During regular market hours, you cannot sell a stock short unless there is an uptick in price. As we discussed in Chapter 8, the uptick rule prevents everyone from selling the stock short unless there are also buyers. This prevents short sellers from ganging up on a stock and driving the price down. In the regular market, it is challenging to short a stock because a very weak stock may not have very many upticks.

Because there is currently no uptick rule in the after-hours market, you can short-sell a stock at any price and at any time. This presents many more opportunities for selling short than even the regular market provides.

A few brokerages have electronic and automatic short sale approval for securities. Others must actually call their clearing firms to determine if a security is allowed to be borrowed. Because checking for stock loan availability requires human interaction, some brokerage firms do not allow shorting in the after hours. In addition, if you intend to sell stocks short after hours, keep in mind many brokers do not allow you to trade on margin after the regular market closes. This makes it impossible to short after hours because a margin account is required to do so. If you think you will be shorting, these are important considerations when choosing a broker.

While short-selling in the after-hours market presents some unusual risks, you can take steps to protect yourself from losses. Here are a few shorting guidelines that may help:

- It is only short stocks that are overbought. Stocks in the after-hours market can rise quickly. In fact, we have seen some small stocks under $5 rise more than 1,000 percent. So while we realize every situation is different, buying only fast-rising after-hours stocks is a good guideline.

- Avoid shorting stocks with low floats under $10 million. Stocks with low floats are generally more volatile, so we prefer stocks with floats greater than $10 million.
- Avoid shorting low-priced stocks (under $10) in the after-hours market.
- Use a stop loss when entering shorts. If your position moves against you by 10 to 15 percent, look to cover your position.
- Do not short simply because a stock is up.
- Look for short entries when there is extremely high volume with little price advance. When the volume is very high and the price is not advancing, it is a possible short entry.

Although there is much more to know about short-selling a stock (we could write an entire book on the subject), just remember that because there is no uptick rule, there are many opportunities to short. Use the limit order book strategies included in this chapter to help you identify when a stock might be topping out. Sell the stock short, and buy it back at the lower price. Happy shorting, and be sure to use those stop losses!

PUTTING THE STRATEGIES INTO ACTION

We have spent many hours watching and researching various stocks as they trade after hours. Our goal was to observe how they traded when various types of news were released, including earnings reports. We noticed that no two stocks seem to react the same way, no matter how many similarities between them. As such, although we have listed several advanced strategies you can use for after-hours trading, it is important to understand that the strategies might not work with each stock. The effectiveness of the strategies is dependent on various factors, including the overall health of the market, the way investors perceive news releases, and outside influences such as interest rates. Therefore, it is important that you are flexible, and only use the strategies that work best for a particular situation.

On occasion, we will see a stock that exhibits many of the most positive traits for effective after-hours day trading; and on January 11, 2000, Yahoo! (YHOO) turned out to be this stock. In fact, if you were trading YHOO after hours on that particular day, you would have been able to use virtually every advanced technique included in this chapter. For this reason, we thought it would be enlightening to give you a summary of what happened after the markets closed that day, as well as point out the various techniques that you could have used.

On January 11, YHOO was scheduled to announce its quarterly earnings report after the market closed. As of 4:00 p.m. EST, the official closing price of YHOO was 397½ before it reported earnings. At 4:15 p.m., pending the announcement of the earnings report, trading on YHOO was halted. When earnings were announced, we learned that YHOO had easily beaten the analyst estimates, coming in about 18 percent higher than expectations. Keep in mind that the price of many stocks will go up in anticipation of better-than-expected earnings, especially with companies like YHOO. We can confidently say, however, that stocks are more likely to drop after a good earnings report than they are to rally, because the news is already built into the price of the stock. But this is why it is difficult to safely predict the direction of a stock after an earnings report.

After being halted for over an hour, after-hours trading resumed on YHOO around 5:22 p.m. An hour later, the price took an immediate hit to the downside on all ECNs. On Island, the stock was trading between $379 and $380, a whopping 17 points below the closing price. At this point, you have an immediate opportunity to cover any short position that you had on the stock going into the market close. Smart traders sometimes short stocks prior to an earnings announcement on the anticipation that the stock will pull back immediately afterward. Although this is a risky strategy and more akin to gambling, you would have had an excellent opportunity to cover your short position for a very large profit immediately after the stock reopened for trading. In fact, it would have been an instant 17-point profit if you sold short near the closing price of 397½.

Due to YHOO's extreme volatility, when it reopened for trading, you also had the opportunity to arbitrage the ECNs. As

we mentioned in a previous strategy, arbitraging the ECNs simply means that you buy on one particular ECN at a certain price and then immediately sell the same stock on a different ECN at a higher price. The most important part about arbitraging an ECN is the ability to do so based on the price differences from one ECN to another, and that was definitely the case with YHOO at that particular time.

Although we were not able to check the price on all the ECNs due to closed order books, we did check out the price differences between ARCA, ISLD, and MarketXT. There wasn't much price difference between ARCA and ISLD, so arbitraging between those two would have been difficult and risky. However, this was not the case with MarketXT. During the time that YHOO was trading between $379 and $380 on Island, it was also being offered at a price of $370 on MarketXT.

It is important to understand that it was not being bid at $370, but rather being offered at $370. This means that you could have actually bought YHOO at a price of $370 on MarketXT and immediately realized at least a 9-point gain by quickly selling your shares on Island. The key to arbitrage is having the ability to make trades on many different ECNs. If you have your own direct-access software, this isn't a problem. However, if you use brokers for your trading, it might be challenging to find a broker that subscribes to both of these ECNs. Please remember that this strategy is quite advanced, and we recommend that only experienced day traders attempt arbitrage.

If you thought YHOO's 17-point drop was significant, it was nothing compared with what happened after only 1 to 2 more minutes of trading. Sometime between 5:23 p.m. and 5:24 p.m., YHOO dropped even further, down to a price as low as $370. At this point, YHOO had fallen nearly 26 points from its previous closing price, only 2 hours before. By now, you probably think the stock was oversold and due for a rebound. After all, it didn't seem likely that it would keep dropping without stopping at any support levels.

Although this line of thinking is generally correct, it is very dangerous to buy a stock solely because you "think" the stock should bounce off the bottom. This is known as bottom fishing, and can be a very risky method to use because if your timing is

off, the stock's downward momentum can continue, driving the price of the stock even lower, causing a large loss. By applying some of the techniques you have learned with after-hours trading, you can buy a stock that has dropped significantly based on proven strategies rather than because you "think" the price will bounce.

Primarily, you need to study the limit order book to see if the spread starts to narrow. This will mean that the buyers are increasing their bid prices, while the sellers have stopped lowering their offer prices. This is usually indicative of a possible trend reversal.

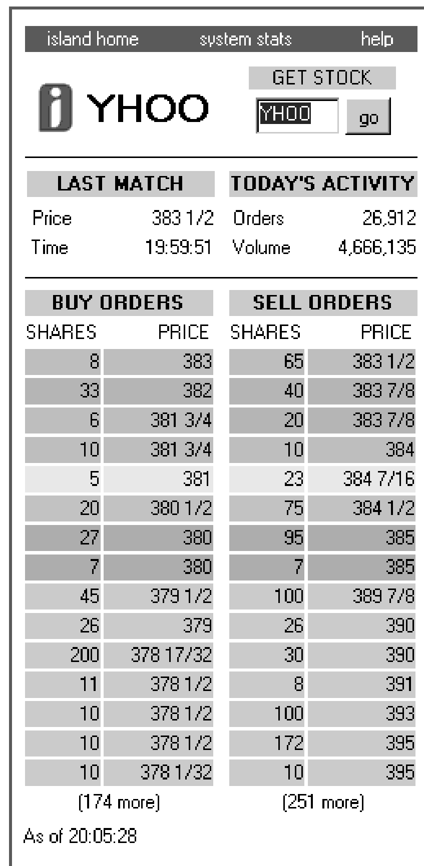
Another helpful strategy is to look at how many levels deep a particular stock goes in the order book on both the bid and offer sides. For example, do you have only one or two people with buy orders on the stock, or do you have twenty different orders to buy? How about orders on the sell side? Are there more orders on the sell side than the bid side? This is important to notice because it indicates buying or selling pressure as the stock moves up or down in price.

Finally, notice the average size of the shares being traded. Remember that you should look for not only a large quantity of buyers or sellers at each price level, but also the average share size, so that you can determine whether it is primarily the smart money or the dumb money that is selling. The larger the share size, the more likely the stock will continue going in the direction in which those large share sizes are trading.

As it turned out, $371 ended up being the bottom price before the stock began to turn around and run in the other direction. If you had noticed that the selling pressure was slowing down around $372 and you had placed an order around 371½, you probably would have gotten your order filled right before the stock turned up. The interesting thing to note is that when the stock bottomed, the bid was $371, but the offer price was $377, thus creating a 6-point spread. You could have immediately placed a sell order near $377 and made at least a 5-point profit. Keep in mind that when YHOO bottomed at $371, it had only been reopened for trading for about 8 minutes. Essentially, this tells us that everyone that wanted out of the stock had gotten out of it immediately after it opened for trading.

By 5:40 p.m., about 15 minutes after dropping to a low of $371, YHOO had already rallied back up to $379, an impressive 8-point bounce off the bottom. By the time Island stopped trading at 8:00 p.m., YHOO had rallied all the way back up to 383½, which now put it 14 points below the afternoon closing price at 4:00 p.m., but about 12 points off the low of that evening's session. Figure 9-4 shows a screen shot of the Island order book on the evening of January 11, the night described above.

FIGURE 9-4 *Island book—Yahoo stock*



island home system stats help

YHOO

GET STOCK

YHOO go

LAST MATCH		TODAY'S ACTIVITY	
Price	383 1/2	Orders	26,912
Time	19:59:51	Volume	4,666,135

BUY ORDERS		SELL ORDERS	
SHARES	PRICE	SHARES	PRICE
8	383	65	383 1/2
33	382	40	383 7/8
6	381 3/4	20	383 7/8
10	381 3/4	10	384
5	381	23	384 7/16
20	380 1/2	75	384 1/2
27	380	95	385
7	380	7	385
45	379 1/2	100	389 7/8
26	379	26	390
200	378 17/32	30	390
11	378 1/2	8	391
10	378 1/2	100	393
10	378 1/2	172	395
10	378 1/32	10	395
(174 more)		(251 more)	

As of 20:05:28

When premarket trading started the next morning, YHOO continued right where it left off the night before—in rally mode. By 9:08 a.m., YHOO was now all the way up to $387. By 9:15 a.m., it was up to a surprising $395, only 2 points below the previous day's afternoon closing price. After bottoming the previous evening at $371, YHOO actually rallied right back up within 2 points of where it previously was during the prior day's market close. This is what we mean by volatility.

We hope you realize it is possible to make large profits by trading stocks after hours, although you must always be aware that the risks can also be quite significant. The challenging part is trying to determine exactly when the stock is about to bottom and buying it at that time. Although the strategies we have discussed will certainly help, nothing is a better teacher than experience. The more you observe stocks trading after hours, the more you will gain the intuition necessary to make successful trades.

TRY DIRECT-ACCESS TRADING FOR INCREASED SPEED AND CONTROL

Let's be honest: Web-based brokers are really designed for the average everyday investor who wants to place an occasional trade on the computer. Although they do extremely well for some investors, more sophisticated and experienced people may prefer faster access and more control over their trading destiny. We recommend direct-access trading software since most online brokerages have limited after-hours execution options.

Direct-access software is often referred to as "point and click." Rather than having to manually enter your orders and selecting the symbol, quantity, and price, you can simply point the mouse at your quotes and buy or sell stocks with a single mouse click. Confirmations automatically appear and are much quicker than for a traditional broker.

You have a number of choices if you want direct-access software. You could consider joining a professional day trading brokerage firm. One advantage is you receive proprietary trading

software, such as Level II screens, that can be loaded on your personal computer at home or the office. Instead of trading through the Internet and a web broker, with direct-access software you can place your trades directly on the appropriate exchanges, without using a middleman. To place an order, you simply connect to the Internet and launch your trading software. Once the software is running, you are free to place as many trades as you want.

While the software varies from one firm to another, these variations all have some basic features in common. For instance, each enables you to view and manipulate an incredibly large amount of data in real time. This is helpful when you want to view real-time charts and technical indicators to assist you with trading. The software also allows you to enter your orders very quickly. Instead of manually typing all your parameters, such as the name of the stock, price, and number of shares, as you would with a standard web broker, direct-access software allows you to simply point and click to enter your orders.

For example, you simply click on the symbol of the stock you wish to trade, as well as the price and the number of shares you want to buy or sell. You then are given a choice of which ECN you want to route your order through. To place your order, you click on a buy or sell button and your order is instantly executed. Within literally seconds, you receive your trade confirmation.

The reason your orders are executed so fast is because this software connects you directly to the Nasdaq and NYSE computers, instead of having to be routed first through a series of other computer networks. You can imagine the amount of time saved by using this software. Day trading and direct-access brokers also seldom receive payment for order flow, because they do not route your orders to a specific market maker. Instead, you are given a choice in how your order is routed, including to one or more ECNs. This ensures that you are always given the opportunity to get the best possible price with each and every trade you place. Best of all, you're in control of your own trading.

Of course, depending on the broker you choose, you will pay a monthly fee to use the direct-access software, usually several hundred dollars. The good news is that this fee is usually waived each month as long as you make a certain quantity of trades. Again, this varies depending on the firm, but many firms

will waive the fee if you make at least a minimum amount of trades per month, perhaps 100 or 200. Even if you do not make enough trades to get the fee waived, it can make good financial sense to use the software because of the amount of money you will save by getting quick executions and better order fills. So if you are serious about after-hours trading, then cost should not be the most important factor here.

Most professional traders already understand the importance of using direct-access software and are using it. Others like to complain about the slowness and bad order fills of their online, web-based broker, yet refuse to switch to direct-access software. If you do not do enough trading to justify the usage of direct-access software, then you will generally do just as well with a good web-based broker. However, if you are annoyed by the slowness and lack of advanced technical capabilities of your web-based broker, then seriously consider switching to a broker who offers direct-access trading.

COMPUTER SETUP

Will you need special equipment to become an active trader? Possibly. If you plan on becoming a serious after-hours day trader, you will, most likely, need to buy the most appropriate equipment. Remember that you can't compete successfully against other traders if you are using slow and unreliable hardware. Although many traders don't think of the consequences of owning outdated equipment, we can assure you that inadequate computer hardware will cost you in time, money, and convenience. Think of trading as a business and realize that it is necessary for you to have the right equipment. Just be sure to maintain good tax records, because the hardware may be tax deductible.

As you might expect, one of the most important elements is your computer setup. When building a computer system to use with direct-access trading, you need to remember two things: Your system must be fast, and your system must be reliable. You will need a fast processor, a large hard drive, sufficient memory, and a data backup device. We recommend using a Pentium II or

III level computer or higher with a minimum 500-MHz processor, but the faster the better. Many computer users prefer the Intel Pentium processors, but you can usually save money with a Celeron or AMD processor. While these newer chips are less expensive, they claim to provide similar processing capabilities to the Pentium chips. For traders, speed and power are everything, so you want a computer that has both. That is why we tend to prefer the latest models.

One of the advantages of a new computer is that it comes with the latest components, such as a DVD, CD-ROM drive or CDRW drive, a 3½-inch floppy and Iomega zip drive, a large hard drive, a high-speed modem, and a video card. Most important, the newest computers are equipped with large amounts of RAM. We recommend at least 128 megabytes, although some of the newer machines have much more. A battery or uninterruptible power supply is also a good idea. This would prevent your system from going down in the event of a brief power outage.

When choosing an operating system, we recommend a Microsoft Windows–based machine for a simple reason: There is more software available for it. There are very few trading and analytical packages written for the other platforms such as Linux, MacOs, BeOS, Apple, and others. Of course, this may change as other platforms gain popularity. But great hardware without corresponding software makes a very expensive paperweight.

In addition, while you're setting up your ideal computer system, don't skimp on the monitor. Monitors are your direct contact with the computer, and in our opinion, the bigger the monitor, the better. You won't believe how easy it is for your screen to get cluttered when you're looking at an ECN limit order book while trying to make a trade. In fact, because trading decisions are based on your ability to absorb and process information, we think you should also consider getting multiple monitors. By having multiple monitors, you will be able to watch more and, the hope is, obtain more critical information to help you trade successfully. We've had great success with 19- or 21-inch dual Sony monitors powered by a Matrox Millennium DualHead graphics card.

Beware, however, that eyestrain is a major cause of fatigue for traders, so be sure to get the best possible screen resolution

you can afford. The good news is that the price of monitors has come down significantly over the years, and if you shop around, especially on the Internet, you can find decent-quality monitors for reasonable prices. If you want the best screen on the market, buy a flat screen. These flat screens, aside from being futuristic looking, are easiest on the eyes, but you will pay dearly for the privilege.

Although it is not necessary to buy all the bells and whistles of the most expensive computer, you do want something that will last a few years and be adequate for your trading needs. Expect to pay several thousand dollars for a good-quality computer with a fast microprocessor. Keep in mind, too, that any computer system you purchase today will rapidly become obsolete, so plan on replacing it within 2 or 3 years, if not sooner.

INTERNET CONNECTION

Nothing is more annoying than having a top-of-the-line computer with a fast internal modem and finding out you are connecting to the Internet at a slow 28K or 31K baud rate. This is exactly what is happening to millions of computer users all over the world. Some explanations for this may include line noise, age of copper wires, and poor routing. Even if you have a 56K V.90 modem installed in your computer, the telephone lines in your home that allow you to connect to the Internet run at a turtle's pace.

The good news for consumers is that local telephone carriers, cable companies, and Internet Service Providers are scrambling to provide you with high-speed Internet access. The rush to install faster communication lines in the homes of consumers has become almost as competitive as the rush by online brokers to give you after-hours trading. In both cases, competition brings down prices, improves service, and increases product choices. If you want to upgrade your telephone line for faster Internet access, you have a number of choices.

Your local phone carrier will be delighted to upgrade your existing telephone line for the fastest possible Internet connec-

tion. First, you could look at installing an all-digital Integrated Services Digital Network (ISDN) line, which is twice as fast as a V.90 analog modem. One of the advantages is that it allows you to access the Internet while talking on the phone or using your fax. This means you don't have to install a second line to use the Internet. Another advantage of ISDN is that it's widely available. No matter where you live, you can generally get ISDN service.

The negatives of ISDN are that it is a dial-up connection, just like your regular phone line, which means you have to dial out every time you want to use the Internet. Your ISDN provider might also limit your use to so many hours per month, perhaps 200 hours, before it starts charging extra. You will also need to purchase a 128K external modem, pay for installation, and pay monthly charges. Another negative of ISDN is that because of new technology, ISDN will likely be phased out over the next few years. Call your ISDN provider if you want additional details.

The newest telecommunication technology is the asymmetric digital subscriber line (ADSL), or the generic xDSL, as some people refer to it, since there are a number of DSL variants. ADSL is quickly being deployed by telephone companies and comes in several variants with download speeds of up to 7.1 mbps, which is approximately 50 times faster than a regular dial-up line. Although ADSL is rapidly expanding, it may not be available in your area since it needs to be in close proximity to a telephone company switching station. If you can get ADSL, this would be our primary choice for trading. Be sure to get the highest speed available in order to handle the traffic during busy periods.

Once your phone carrier installs ADSL, it is on 24 hours a day, meaning you don't have to dial your Internet provider to use it. Another advantage is that it uses a dedicated line, so your connection speed is unaffected by the number of people using the Internet. Just like ISDN, you can share a fax or phone with your computer's Internet connection, so you won't have to install a second or third phone line. The cost is about the same as ISDN but could drop as more people use the service. You have to pay a one-time connection charge and pay for an internal or external modem.

Another choice is a cable modem, which will provide direct, permanent access to the Internet via your television cable connection. With a cable modem, you get high-speed access to the Internet for a very reasonable cost. Because a number of cable companies are still testing the equipment, however, cable modems may not yet be available in your area. Also, cable modems do not offer a dedicated line, which means you are sharing bandwidth with other consumers. If there is a lot of volume on the Internet, your connection could run slower, with peak usage generally in the morning between 6:00 and 8:00 a.m. and in the evening after 6:00 p.m. Unfortunately, these are precisely the times that after-hours traders will want the system to be the fastest, so cable modems may not be as well suited for after-hours trading.

The fastest, most reliable Internet connection choice for active traders is a T1 line. This kind of dedicated line is popular in day trading firms, but it can cost thousands of dollars per month, well beyond the budget of most individual investors. A T1 communication line gives you instant Internet access, a thousand times faster than your regular phone line. Most day trading firms have installed T1 lines so customers don't have to wait more than a microsecond to place a trade. If money is no object, however, and you want to be connected all the time at a fast speed, a T1 line represents the most reliable Internet service.

If the expensive T1 line does not fit within your budget, the best choice, as we noted above, is the xDSL technology, specifically ADSL. And if ADSL is not yet available in your area, then the next best choice at this time would be ISDN. In the future we believe that there will be wireless options available via satellite for local multipoint distribution service (LMDS), so that all homes will have high-speed Internet access.

TALKING TO THE EXPERTS

For our final chapter, we interviewed two successful short-term traders, Halbert Uy and Michael Campion, who trade stocks any

time of the day or night. Hal loves to aggressively trade the most volatile small-cap stocks, while Michael tends to favor the medium- and large-cap stocks. One of the best ways to learn how to trade well is to find out what works for other profitable traders. We believe you'll find the interviews enlightening and helpful.

10

THE NIGHT TRADERS: INTERVIEWS WITH TWO PROFESSIONALS

INTERVIEW 1

HALBERT UY: CHASING SMALL-CAP STOCKS

Halbert Uy is a professional after-hours trader and manager of a hedge fund. He is a graduate of Brown University. He left graduate school so he could pursue his dream of being a full-time trader. He resides in Maryland with his wife, Devlin.

Michael Sincere: What kind of an after-hours trader are you?

Halbert Uy: I'm an opportunistic trader. I'm trading news and momentum and individual stories, not the overall market. It is different from someone who is trading a basket of stocks or sectors and is interested in the overall direction of the S&P futures. I am also very flexible. I'll change my strategy to try and adapt to market conditions. If there is a news play that has some life to it, I might sell after a point or two but will also try and hold the stock for a much larger gain. If the news play pops and then dies, I'm looking to scalp. The market is difficult enough, but it's almost impossible to adapt a fixed

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strategy to all market conditions. In order to succeed as an after-hours trader in the long term, you have to adapt to market conditions rather than forcing a fixed style onto the market.

Sincere: Is trading news your number one strategy?

Uy: Basically I am looking for the hot spots, what I call the flavor of the day. I am not playing the same stock everyday. For example, a few months ago, Linux was very hot, so you had a whole list of other companies with Linux news releases that were also hot. I am looking for small stocks with floats under 10 million and capitalization under 100 million that will run on news. Sometimes these stocks can go up by triple-digit percentages.

Sincere: Do you have any advice for people who want to trade on the news?

Uy: First, what you see on TV is usually not news anymore. By the time CNBC or CNNfn picks it up, it could be an hour or two later. When I see it on TV, that is my signal to sell. I will sell to the novice investors who see a stock mentioned on TV and decide to buy it. This is what we call "dumb money." They are coming home from work and finding out that a stock is up 100 percent on Island or Instinet. There are a lot of strategies you can use to take advantage of breaking television news, but it's usually the opposite of what everyone else is doing.

Sincere: I assume you don't care much about the fundamentals of a stock.

Uy: I'm not looking for Graham and Dodd value plays. I want stocks that will move quickly in a short period of time. The fundamentals are not important to me. What is important to me is whether there is catchy news, how thinly traded the stock is, and what is the float. These are the criteria I look for.

Sincere: What do you mean by float?

Uy: "Float" is loosely defined as the shares available to be traded. You take the number of shares outstanding and

subtract the number of shares owned by company employees and major shareholders. The Yahoo! finance web site has the float figures. Generally, stocks with smaller floats are more volatile than those with larger floats. When I'm trading stocks on positive news, the smaller the float the better. I look for floats under 10 million.

Sincere: Is it worth it for the average investor to participate in the after-hours market?

Uy: If you are an investor, there are two ways you can go long a stock. Either you can buy it from someone or you can wait for someone to sell it to you. If you are looking to buy it from someone, you have to look for an offer or ask. If you want to buy Intel at $123, you have to actively look for a seller. If there are no offers that you want to take, you can put in a bid in the limit order book and hope that someone will sell it to you. This is called "passive buying." For investors, the after-hours is better for passive buying and selling.

Sincere: Is it easy for investors to find bargains in the after-hours market?

Uy: It's very possible. A stock called Santa Cruz (SCOC) was halted at the end of the day on pending news. When it opened for trading in the after-hours market, there was panic selling. The stock was selling as low as $7 a share. People saw the company missed earnings, and they wanted out of it at any price. It traded to an excessively low level. Whenever you have negative news, it draws out sellers. When the selling gets excessive, buyers will eventually take a stand. When the panic selling finally stopped, SCOC turned around. It opened the next day at 8⅛ and closed at 12 11/16. You got a double 2 days later. If you believe in a company long term, you can sometimes get good bargains in the after-hours session.

Sincere: Do you have any other advice for long-term investors?

Uy: First, unless you are playing with fast-breaking news, stay away from small speculative issues. Focus on the

large-cap stocks like Microsoft and Intel. You can use the after-hours market to initiate positions on stocks that are traditionally strong but might be down. Another idea for investors is to use the after hours to sell a stock you are holding. Let's say you own a stock that is mentioned on CNBC and the stock is bid up. You would use that excessive mania and liquidity to exit an existing position. Another idea is to take all your limit orders and extend them into the after-hours market. It doesn't matter if you get filled in the regular market or after hours.

Sincere: What about investors who are on the wrong side of a trade?

Uy: You don't want to be exiting after an extreme position. A guideline I use is if you see a stock down 15 or 20 percent in after-hours trading, it is too late to get out. If a stock goes down by 20 percent or more and it is a well-known blue chip like Dell or Cisco, you might consider adding to your position.

Sincere: How should an after-hours trader get started?

Uy: Whenever you talk about beginning anything, start small. Don't expect to come in and trade the same amount you do in the regular market. Reduce your amount by 50 or 75 percent. Also, don't trade more than 1,000 shares, because it might too hard to get filled, especially with small-cap stocks.

Sincere: When do you start looking for after-hours plays?

Uy: I look for the tone of the day around 3:00 p.m. First, I look at all the news wires—PR Newswire, Business Wire, Bloomberg News, Reuters, and Dow Jones. I'm scanning the stories looking for key words. One week, the Biotech Index (BTK) dropped from 806 to a low of 471. I was buying the biotech stocks in anticipation of a stronger opening the next day. I bought GeneLogic (GLGC) at $40 after hours and sold it the next day in the 50s. When I look at a stock, I look for key words. Then I look at the quote and see if it is a low-priced issue. Many of the stocks I'm interested in are low-priced stocks under $12 a share.

Sincere: Isn't this kind of risky?

Uy: For the average investor it is. But I'm going into all these plays with defined risks. For example, I will look at a stock and determine my entry point minus the low of the day. If a small-cap stock opens at $1 and trades up to $3 and news is released late in the day, I'm not a buyer at 3⅛. To be first requires a professional system with streaming quotes and the ability to read very fast.

Sincere: Do you use technical analysis to determine when to buy or sell?

Uy: Absolutely. With the biotech index, everyday it gapped up and broke the lows. I was looking for a double bottom, but it actually tanked from the morning and then traded up. I waited to see how the index closed in the after hours. If it didn't close into the highs, the momentum wouldn't be strong enough to carry into the next day. My strategy was to buy the biotech stocks into the continuation of the momentum, and in this case, it worked.

Sincere: Like most traders, you want fast execution at the most competitive price. How do you get both?

Uy: The key is speed. I need fast, reliable quotes and the ability to execute orders with all the major ECNs in order to get competitive prices. I also need access to all the ECNs. If you want to trade effectively after hours, you need to trade among all the ECNs in a fast and easy manner.

Sincere: What kind of computer setup do you have?

Uy: I have four computers and eight monitors with a high-speed Internet connection. On one computer, I have my Level II screens and order entry. On another terminal, I have my news feeds. The other computers are used to monitor the chat rooms and conduct research. My Level II screen allows me to see a half dozen limit order books at one time. I am constantly looking at price and volume.

Sincere: Could you make a living only as an after-hours trader?

Uy: Not yet. There isn't enough volume or liquidity right now. If you want to trade strictly after hours, you are limiting yourself. Unlike some people who try and learn about individual stocks, I am searching for opportunities, like earnings releases or other types of breaking news. These opportunities can happen at any time of the day or night, so I always have to be ready.

Sincere: How do you trade earnings releases?

Uy: The best way to trade earnings is to remember that the number is not important. For example, if Cisco Systems beats estimates by a penny, that doesn't mean a thing. What you really need to know is the whisper number, which isn't announced to retail investors. Unless you are a big client, it will be difficult for you to play earnings releases. What you want to do is play the conference call. During the conference, the stock will trade wildly. It will trade not on the number but on its outlook. It's a very difficult strategy, but profitable. What I like are stocks in the Russell 2000 that missed their earnings by a penny; then someone comes in to sell 5,000 shares, driving the stock down by 30 percent. That's when I am looking to buy. I'm looking to buy panic or short euphoria.

Sincere: How about split announcements?

Uy: Splits are a great way to make money. If you play the split early, as soon as it is released, it is great; it will usually gap the next day, and you can make a very fast gain. But it's a very tough game to play. The best way to play it is immediately, when they are first announced.

Sincere: It sounds like you really like volatility.

Uy: I love volatility. Although the small-cap stocks are riskier, I predefine my loss. I never could have made the kind of return I did on New Tel Ltd (NWLL) if I had been trading Microsoft or Intel. As long as you keep your losses small and to single-digit percentages, it's worth it to me to do after-hours plays. I play whatever is hot. With NWLL, it was China, Internet, and ISP. I didn't expect it to go up that high. I got lucky.

Sincere: Who else is playing the small-cap stocks?

Uy: I hate to say it, but a lot of uninformed traders. I am competing with people who are trading the Nasdaq small caps when they would be better off in large, well-known companies. Most of the institutions are in large-cap stocks because the small caps don't have enough liquidity. So with small-cap stocks you get low volume and high price swings. When earnings on these stocks come out, the price could go down 20 or 30 percent below the close. The dumb money is panicking, and what I try to do is buy at those times. I'd rather play against the novice day traders than the institutions. It's kind of like playing poker with children in first grade or in twelfth grade. I want to play against the first graders.

Sincere: What other mistakes do novice traders make?

Uy: They react to news on thinly traded issues. The stock will be driven down on the news, and instead of doing nothing they will sell in a panic. Then I go on Island ECN and buy whatever I can get my hands on. For example, Globe.com missed its earnings by 3 cents. The stock fell by 30 percent in the after-hours market. Then someone came in with a sell order for 10,000 shares and I immediately matched it. I make money on inefficiencies like this. You really have to be careful if you are a novice after-hours trader trying to play the small-cap stocks or illiquid stocks.

Sincere: How does the lack of liquidity affect stocks?

Uy: In a normal day you can buy 2,000 or 3,000 shares of a stock and not move it at all. In the after-hours market those same 3,000 shares might take out all the available offers. On the sell side, it could drive the price of the stock down 30 or 40 percent. On low volume, moves can become very exaggerated.

Sincere: But you have done very well trading in the after-hours market.

Uy: Like I said, before I enter a position, I am very careful to define my risk. I don't think how much I can make on

a stock—I think how much I could lose. The goal of the game is not to make as much money as you can; the goal is not to lose money. Winning is easy if you eliminate or reduce losses. That is one of the reasons I have been successful, because I have kept my losses to a minimum. I also know in advance that I am a trader, not an investor.

Sincere: What do you mean?

Uy: Many people go into a trade that goes against them, and instead of cutting their losses and getting out, they hold the stock and hope it comes back to even. You are no longer a trader but an investor. You become a "stuckholder" because you are stuck holding the stock and are afraid to sell it for a loss. This happens all the time to people.

Sincere: Do you ever short stocks in the after-hours market?

Uy: All the time. The market makers and specialists have turned off their quote machines and have gone for the day. You'll suddenly see these small-cap stocks go from $3 a share to $15 on old or useless news. When you have illiquidity, these stocks can swing wildly one way or the other. I take advantage of that.

Sincere: How do you know whether to go long or short?

Uy: First, if the daily average trading range of the stock is 10 points higher on low volume, that is excessive and a possible short play. If there was high volume, it might be a good long play. What I look for is extreme buying so I can short and panicked selling so I can go long. Because there is currently no uptick rule in the after-hours market, I can sell a stock short while it is going down. When I short after hours, I look for extremes. You are looking for stocks that are trading up on low volume. You are also looking at the float and the number of shares outstanding. I am looking for a large float because you know the next day these people are going to be sellers. I will short stocks that are running up excessively on news, but I tend not

to short the Internets because they rise too much on promises.

Sincere: You agree that shorting after hours is a very difficult strategy?

Uy: Shorting after hours can be very dangerous. Once I shorted a stock called Ariel Corporation (ADSP) the day before Thanksgiving at $13, and it ran to $40 in after-hours trading on less than 5,000 shares. I lost $70,000 in one day although the stock eventually came back down and I ended the week up. You really need to have superb money management skills and discipline. For instance, you don't want to risk more than 10 or 20 percent of your account on a short position. Some brokerage firms have to manually approve shorts where they have to call the clearing firm to see if shares are available. On the other hand, Datek Online has automatic approval. When you enter an order in Datek, its system automatically recognizes whether the stock is available to short or not. You really have to call each brokerage to find out the rules.

Sincere: Speaking of shorting, do you think a bear market will kill the enthusiasm for after-hours trading?

Uy: After-hours trading is here to stay, and nothing is going to change that. It is based on the fact that people feel empowered and excited about after-hours trading, although sometimes confused. Right now the after-hours market is concentrated on individual stories and big news after the close. In the future I see people trading more during the after hours as a matter of convenience, and this will happen no matter what kind of market we're in. I think a bear market will provide savvy traders additional ways to make money, including shorting.

Sincere: Other traders have talked to us about market manipulation. Have you seen this happen?

Uy: Sometimes you see fake bids and offers in the limit order book. You'll see 5,000 or 10,000 come in as the top bid, and then you'll see these little bids step in front of

them. Someone is trying to push these stocks up for a reason. The best way to avoid getting faked out is by studying the prices in the limit order book. With small-cap issues, you will sometimes see strange numbers like 1,015 shares at $10. This could be people buying and selling between themselves to drive up the price of the stock. So you have to look out for oddball bids and offers.

Sincere: Do you have any final advice for people who want to be after-hours traders?

Uy: First, educate yourself about ECNs and learn the rules. Second, learn to short. Remember that markets move in three directions: up, down, or flat. The public seems to only make money in up markets. You can't sit idly by for markets to go up. Third, after-hours prices are not as important as prices during the regular day. They represent thin trading by uninformed players. Finally, start small and play small. Don't get yourself trapped in excessively large positions.

INTERVIEW 2

MICHAEL CAMPION: THE PSYCHOLOGY OF TRADING

After serving in the U.S. Navy aboard the *U.S.S. Enterprise* in an antisubmarine squadron and doing a stint as an executive, Michael Campion joined Pristine.com, a firm for self-directed traders, as an in-house trainer. He is primarily responsible for training Pristine's newest short-term traders. Michael also was a contributing writer to Oliver Velez and Greg Capra's book, *Tools and Tactics for the Master Day Trader* (McGraw-Hill).

Michael Sincere: Tell me what you think after-hours trading is like.

Michael Campion: This is a business more like boxing than anything else. I can teach you everything you need to know about boxing. But when you go out into the ring

and someone hits you, your best-laid plans have been knocked out of place. You're against the ropes and woozy. The question is, do you step back into the fight and rely on the skills you have learned so you don't get knocked out or do you start flailing your arms? After-hours trading is very similar. You know you're going to get hit, but you don't want to get knocked out. It is not a game of luck. It takes skill to be successful.

Sincere: What are these skills?

Campion: I would say the biggest is discipline. I don't care what your background is or where you came from. If you don't have discipline, you're not going to survive in the regular market or after hours. In the after-hours market, it is not about logic; it is about news and perception. You are basically trading against people who usually get the news wrong. If you are disciplined, it will be easy for you to pick people off.

Sincere: Can you be more specific?

Campion: Let's take what happened to ZixIt Corporation (ZIXI). One day it was bidding up to $100 a share in the after-hours market from $86 at the close. The following morning it dropped back to $86 a share. If you didn't have discipline, you would have chased the stock into the hundreds and gotten hurt. It can be a sucker's bet if you're not careful.

Sincere: So how should a beginner develop discipline?

Campion: First, you should walk in every day with a plan. With a plan, you will not become a victim of the market. You must come in every day prepared to trade against professionals. You don't just wing it. If you wing it, you might win a few times, but on the whole you will end up losing. Without a plan or discipline, you might as well open the window and throw your money out. You are constantly trying to save yourself from yourself.

Sincere: Could you give me an example of your after-hours plan?

Campion: First of all, my day starts the night before. I have a list of what I'm looking for in a stock and whether it meets my criteria. I use sources like TheStreet.com and CBSMarketwatch.com for information, along with our regular news feeds that are built into our system. I will look at a daily chart to see if the stock is moving into prior resistance, or moving down into prior support. Most likely, I will be trading stocks I am already holding to exit by selling at a higher price. I want to take advantage of any strong volume that is coming into after hours. I'm always checking to see who is reporting earnings on which day that week. I can usually get an idea of where the rotation of money is going, for example, from the biotech to the Internet.

Sincere: It sounds like you have a regular routine.

Campion: Good trading is boring. It's doing the same thing over and over again. I have my basket of stocks I trade every day. I look at how they trade during the day, how they closed, if they are in an uptrend or pulled back from a new high. I also look closely at volume and look for the strongest stocks in certain sectors. If a stock is up for 5 days in a row and moving up to an area of resistance, I might go short. The S&P futures premarket is also a guide for what might gap up. Many times a stock might finish the day strong with good volume and bleed into the next day. These are some of the things I look for.

Sincere: Are there unique advantages to trading in the after-hours market?

Campion: You get the opportunity to pick up more shares of a stock like America Online (AOL) in the after-hours market. For instance, AOL had just announced a split, and within minutes of the breaking news one of my traders was able to grab a quick 10,000 shares on Instinet and turn around and flip it for 2 points, pocketing a quick $20,000. The market hadn't reacted to the news fast enough. The next morning, the general public woke up and wanted to buy it. It was like shaking a Coke can and

then taking the lid off. AOL gapped up the next morning by another 3 points.

Sincere: Are there special tools you use to help you with after-hours buying and selling decisions?

Campion: Looking at the limit order book and getting a sense of buying or selling pressure is helpful. My background in trading is in reading a print. I primarily depend on Level II direct-access software like the Executioner. This way I can see what is happening to a stock and take advantage of it. The only way I could have taken advantage of the breaking news on AOL was by direct-access software. For professionals, there is a huge difference between direct-access software and an online broker. With an online broker, you don't get to see the full liquidity of a stock after you enter your order.

Sincere: Won't the limit order book show you the depth of the market?

Campion: If you are using the Island limit order book, for example, you can only see the orders on Island and can only execute against those orders. Level II allows you to see everybody who's willing to participate. Let's put it this way: Level II gives you the ability to see everyone who wants to participate as a buyer and seller. It shows me Island, Archipelago, REDIBook, and all the other participants. The limit order book only gives you a piece of the puzzle. I'd rather see the whole picture than have a peephole view. If I am going to do professional after-hours trading, I want to see everyone who is sitting at the table with me. I want to know who's coming to dinner.

Sincere: Wouldn't a super limit order book allow you to see all the market participants?

Campion: There has been a lot of discussion about creating a super limit order book. But I'm talking about right now. Instead of sending in a blind order, the key is to see all the market participants willing to buy or sell that particular equity. Otherwise you won't know what is going on.

Sincere: What are some of the tricks others play in the after-hours market?

Campion: They will try and influence the movement of a stock. Someone will go on an ECN and flash a 10,000-share lot to buy something. You think the stock is going up. On another ECN they are selling it short and you don't know it. Then they pull the bid, which causes the buying pressure to vanish, and then the stock is bid lower and you have no way of getting out. Everyone is running for the fire exit at the same time. It's a fake-out, and they got you. It's not what is displayed that is important; it's what they actually do. The truth is in the print. Another nice trick is to display a portion of the order and hide the rest, not giving you total transparency. After-hours trading is more emotion-driven than anything else. Until the liquidity is present, which I believe will come, buyer beware.

Sincere: What can individuals do to protect themselves?

Campion: Trading is really about honesty. You must have the ability to admit that you are wrong. The pros who do it for a living will lose, but they lose nominal amounts. Who wants to lose? No one does, but that is part of our business. You don't see many books titled *Trading to Lose.* You must be able to tell yourself that a stock has possibly gotten out of hand or maybe the spreads have opened up too much. No matter what, we don't chase stocks. In terms of initiating positions, you have to be very careful in this environment. Just use common sense.

Sincere: What should traders watch out for?

Campion: Let's say that news breaks that Chase has great earnings and people step into the stock without looking at a chart to find out it's moved up for five straight days into a prior high or resistance. All they think about is that it is a great company. A trader doesn't have feelings about whether it is a great or lousy company. The truth is in the trade, in the print. At this point, as they bid it up in this frenzy, we may sell short. Too many people get emotion-

ally involved with what they think is good news, and they end up getting hurt. The next day, although you think it is good news, you didn't hear the conference call with the analysts, and you weren't able to hear the real truth with the numbers. The perception is that maybe they can't produce those kind of earnings the next quarter. What you think is good news is not good news at all.

Sincere: But there are opportunities to make money in the after-hours market?

Campion: If you're quick and nimble. Although the majority of our trades are made through the regular market, you can take advantage of quick movements in stocks in the after hours. I look for pockets of liquidity. I want to be able to fish in the pond with the most fish. The hour after the close is probably the best time for after-hours trading. And a half hour before the market open. Things are starting to happen. In the morning, if the stock looks right, and I get a feel for the market, and the S&P futures are moving up, I will participate before the market opens as long as it doesn't gap excessively. You have to look at price and volume. You kind of test the waters. You try to rein yourself in and not get overly exuberant. Take one step at a time.

Sincere: How about trading the teenies?

Campion: Most of the people who trade the teenies enter and exit immediately. They are very attuned to what they are doing. It is difficult for beginners to trade the teenies during the day, and at night there isn't as much liquidity and the spreads are bigger. The odds are stacked against you. I think after-hours trading is perfect for people who are already in positions and perhaps want to sell at higher prices and have a specific news-driven stock. Although you will find teeny players in the after-hours market, it is rare to see beginners. Usually they are seasoned scalpers. On the other hand, it is virgin territory and there is an uninformed pool of people out there you can definitely scalp against.

Sincere: Do you have any final advice for the novice after-hours trader?

Campion: I would say that winning comes from confidence and confidence comes from preparation. Prepare yourself by getting the best education possible, as it will be cheap in the long run compared with finding out the hard way on your own. Prepare yourself mentally by seeing yourself as a winner and a champion.

EPILOG: WHAT HAPPENS NEXT?

Now that we have described some of the benefits and risks of after-hours trading, we hope you'll try it for yourself. For those of you who already have an online broker, enabling your account for after-hours trading is more than likely a very simple process. On your broker's web site, simply log into the extended-hours trading section, read and agree to the disclosure statement, and you're ready to place your first trade.

If you are a novice investor and do not have an online account, this might be a great time to start one. There are more than 100 brokers to choose from, and most of them don't require large sums of money to open an account. Select a broker that allows you to trade at the times you are interested in, offers the stocks you want to trade, and provides a relatively stable and efficient operating system. Be sure to ask how a broker processes your orders and which ECNs it subscribes to.

If you want to be an active after-hours trader, we recommend that you choose a broker that works with an ECN that offers sufficient liquidity. You can generally find more liquidity when you stick to the actively traded stocks, and stay away from smaller, less active ones. Remember, too, that cheap commissions shouldn't be the only reason for choosing a broker. Rather,

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you need to choose a broker with an after-hours session and an ECN partner that matches your trading needs.

In addition, before you buy your first stock, be sure you adopt some personal trading strategies that make sense to you and can help to protect your assets. While the manner in which trades are executed may be changing, the basic principles on which you base your stock choices should not change. For example, if you are a conservative, long-term investor by nature, by all means don't feel that you have to change your investment style. Select your stocks in the after-hours market just as you would in the regular market, based upon a company's fundamentals and potential for long-term growth.

Likewise, just because you can trade longer and more often, don't be fooled into thinking that more trading necessarily means more profits. In fact, a study by Barber and Odean, noted earlier in Chapter 6, suggests that overtrading really is dangerous to your wealth. This research, which tracked the behavior and trading results of investors who switched from phone-based trading to online trading, showed that turnover in the average portfolio increased from 74 to 96 percent. Investors also became twice as speculative in their trading when going online. Interestingly, the conclusion of this study is that investors who go online trade more actively, more aggressively, and less profitably. Don't let this happen to you. Whether you are a conservative or more aggressive investor, develop a strategy that suits you and stick with it, especially when trading after hours.

Although it is true that some traders we know consistently make money in the market, it doesn't happen overnight. It often takes years to gain the knowledge, develop the strategies, and acquire the discipline needed to be consistently successful. It has little to do with intelligence, however. Even the most intelligent people can have trouble in the market. Why? Because the market is bigger and smarter than any of us. Once you realize the power of the market, you will stop fighting and start winning.

You are now in a perfect position to profit from what you have learned in this book. Because the after-hours market is so new, you have the opportunity to get involved early—before the rest of the world realizes that the market has changed. We want you to reap the rewards of a successful financial system where the rich are not the only ones who get richer.

Thanks to ECNs and the leveling of the stock market playing field, many people with average incomes are able to share in the wealth of this new economy. In the after-hours market, individual investors armed with knowledge and the latest technology are breaking up what was once an exclusive game primarily played by powerful institutional investors and wealthy individuals.

If you participate in the after-hours market, you are going to be part of stock market history. In fact, we predict that future generations will look back in awe at the early twenty-first century and marvel that so much wealth was created for so many people, and that so many changes were accomplished in such a relatively short time. We have come a long way from an exclusive physical stock exchange where people yell and signal each other to an electronic trading network free from human interaction. ECNs and after-hours trading are only the beginning. We still have a long way to go, but of this we are certain: One day there will be a continuous 24-hour global exchange. In fact, Datek Online is moving toward a 20-hour trading day, and Instinet is opening up a brokerage that will allow small investors the capability of trading 23½ hours a day.

Our goal was to give you access to the same advantages the pros have enjoyed for years. Perhaps this is one reason why so many are uncomfortable about giving you too much information. You might hear comments from some pros that retail investors don’t need free and immediate access to quotes, shouldn’t receive breaking news announcements, and don’t need to trade at any time of the day or night. There are many that feel that if you know as much as they do, it could confuse you.

As you can guess, we don’t share that view at all. It doesn’t matter if it’s the stock market or a used car lot; those with the most knowledge are going to win. The only way to beat them at their own game is to acquire as much knowledge as they have. You don’t need an advanced degree in business to be a profitable trader. Some of the most important lessons can be picked up by good old-fashioned trial and error.

There are also a lot of major market participants who want you to succeed. After all, the more you trade, the better it is for business. Although there is a lot of blame to go around about the way things used to be, we hope this will be the start of a new Wall Street, one in which retail investors are treated as equals

with institutional and professional investors. Although we can't change the past, we can definitely hope the future will bring a more efficient, equitable, and profitable stock market for anyone who chooses to participate.

All that is missing is you, the retail after-hours trader. Never in the history of Wall Street have you had so much power to change the way that Wall Street does business. The incredible growth of the U.S. economy, the power of the Internet, and the increased sophistication of the retail trader have made after-hours trading a reality.

It was quite a challenge to write about a topic that is changing so rapidly. Whether or not ECNs become a permanent fixture in the future global market, they have created such intense competition among the major players that trading will never again be the same. We believe the market of the future will provide people all over the world with breathtaking opportunities to improve their lives. The only limit to how much wealth you create for yourself is the limit you place on yourself. If you play your stocks right, it is possible for you to find your own personal pot of gold.

We are gratified that you took the time to read our book. Whether you are an investor, a night trader, or an insomniac, it has been our pleasure to reveal everything we know about this new and fascinating market. Once you experience it for yourself, your self-confidence will grow, allowing you even more opportunities to generate wealth for you and your family.

Finally, we hope that as your financial condition improves, you do not forget about those who need your help. Although money is important to help you to reach your life's goals, it is only a means to an end. No matter how much money you make or how wealthy you are, we hope you never forget the really important things in life. With increased wealth comes increased responsibility. All we ask is that you try and make the world a little better than you found it. With that in mind, we wish you well and hope you are successful. It has been a pleasure to serve you.

APPENDIX

WHERE DO YOU GO FOR HELP?

WEB SITES DEVOTED EXCLUSIVELY TO AFTER-HOURS TRADING

After Hour Trades (www.afterhourtrades.com)

After Hour Trades is a financial site dedicated to building a financial community on the Internet. It provides free financial information including after-hours trading information through Island, Market XT, and quote.com. After-hours updates are available in real time after the markets close every market day. These updates alert patrons to any important news released after the close, such as important earnings releases, a recap of the day's market events, and stocks that are worth monitoring for the next day.

Midnight Trader (www.midnighttrader.com)

Midnight Trader is the premier online provider of real-time after-hours financial news and analysis for both the individual and institutional investor. This Internet-based extended-hours financial news and data service provider has developed a proprietary

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screening software, correlating after-hours trading activity to the regular session. Midnight Trader is currently one of the newest and most rapidly expanding online media businesses for the active online investor. In an effort to keep all investors better informed of news and information in the after-hours market to help them trade more effectively, Midnight Trader was created.

Both Midnight Trader and After Hour Trades provide daily and weekly stock picks, quotes, market commentaries, research tools, stock analyses, and trading strategies for the active investor.

ELECTRONIC COMMUNICATION NETWORKS

Island (www.island.com)

Instinet (www.instinet.com)

Archipelago (www.tradearca.com)

REDIBook (www.redi.com)

MarketXT (www.marketxt.com)

Bloomberg Tradebook (www.bloomberg.com)

Strike (www.strk.com)

NexTrade (www.nextrade1.com)

Attain (www.attain.com)

Brut (www.ebrut.com)

USEFUL WEB SITES FOR AFTER-HOURS TRADERS

www.bigcharts.com

www.briefing.com

www.cnbc.com

www.cnnfn.com

www.dowjones.com

www.fool.com

www.foxmarketwire.com

www.hoovers.com

www.i-cap.com

www.justquotes.com

www.marketwatch.com

www.nasdaq.com

www.nyse.com

www.quote.com

www.sec.gov

www.siliconinvestor.com

www.thestreet.com

www.tradingday.com

www.wallstreetview.com

www.whispernumber.com

www.yahoo.com

REAL-TIME DATA FEEDS

www.atfi.com

www.bloomberg.com

www.bmiquotes.com

www.bridge.com

www.cqg.com

www.dbc.com

www.dowjones.com

www.dtn.com

www.interquote.com

www.pcquote.com

www.qcharts.com

www.reuters.com

www.spcomstock.com

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ABOUT THE AUTHORS

Michael Sincere began trading stocks through the Internet beginning in 1995. As an early online trader, he researched and interviewed some of the top financial experts in the country. He wrote about what he learned in his first book, *101 Investment Lessons from the Wizards of Wall Street*. Michael is also an experienced corporate trainer, currently employed as a columnist for Pristine.com, one of the largest online educational services for self-directed traders. He can be reached by e-mail at mikesince@earthlink.net.

Deron Wagner is a professional day trader, an independent consultant, and the manager and head trader of the hedge fund., Intraday Investment Fund. Deron can be reached by e-mail at deronw@mindspring.com.

Both authors are long-term day traders who trade any time of the day or night. They use long-term and short-term strategies to make money in the market, as outlined in their previous book, *The Long-Term Day Trader*.

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