

The background of the top half of the image is a dark, slightly blurred blue-grey color. Scattered throughout are numerous translucent, iridescent bubbles of various sizes. Inside each bubble is a glowing green dollar sign (\$). The bubbles vary in focus, with some appearing sharp and others blurred in the background. The overall effect is one of floating money or financial growth.

Little Fish **BIG POND**

**How to Start Day Trading
With Minimal Start-Up Capital
(and *NOT* Get Eaten Alive!)**

by Leroy Rushing

Little Fish, Big Pond

How to Start Day Trading
With Minimal Start-Up Capital
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Key Points:

- SEC defines “pattern Day Trader” as someone who makes four or more day trades within a five-day span
- Pattern Day Traders must have a minimum of \$25,000 in their account to continue trading any stocks
- This makes it difficult for new traders and small account holders to start trading

Little Fish, Big Pond: How to Start Day Trading With Minimal Start-Up Capital (and NOT Get Eaten Alive!)

Introduction

During the boom years of the late 1990s, there were an unprecedented number of new traders entering the hot stock market. It was like a gold rush of sorts with everyone looking to cash in on the charging bull. Unfortunately, with boom comes bust. Thousands if not millions of people were wiped out, and financial institutions were left to cover forfeited margin accounts.

In 2001, the Securities Exchange Commission (SEC) implemented a law restricting day trading. It stated that anyone who opens and closes a position on the stock market four times out of five trading days should be considered a "pattern day trader." Once identified as such, all pattern day traders must have a minimum of \$25,000 in their trading accounts each day before they can begin trading.

This regulation protects both the trader and the financial institution. Day trading is an inherently risky venture. During the boom years, many traders did not understand the risks they were taking and in some cases were deliberately misled



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Key Points:

- **Small account holders can address the challenge of the \$25,000 minimum through several different methods**

by unscrupulous brokers. By requiring a \$25,000 minimum, traders cannot "lose everything." Likewise, the financial institutions securing the margin accounts also reduce their risk.

This is a good thing overall for the market, which is what the SEC is ultimately concerned about. However, it also presents a number of challenges for the beginning day trader, the "small account holder", who does not necessarily have \$25,000 to start.

In this e-Book, we will discuss these challenges, give a summary of what you need in your trading plan and provide an overview of two potentially lucrative ways to overcome these challenges. We will also review some of the pitfalls of small account day trading, show you how to avoid them, and consider some options available to small account holders that may allow you to pursue your day trading activities more freely.

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Key Points:

- Principles of Day Trading are the same no matter how much capital you have to start
- However, small account holders are open to more risk
- Start by developing a solid trading plan that includes risk management, trade strategy, and money management methods, and devise a way to track your performance

Challenges and Solutions for Small Account Day Traders

The principles of a good day-trading strategy are the same at every level. Day trading is an inherently risky activity, so the prime goal of any day trader, whether a large or a small account holder, is preservation of capital. However, this presents a greater challenge for the small account holder because he or she has less capital to trade with, less opportunities for trades, and much less room for error.

So how does the small account day trader compensate for this? First, it is important to remember that you should plan to grow your profits incrementally. Just because you start with a smaller account does not mean that you should try to "catch up" faster - in fact, you should prepare for just the opposite.

Most importantly, however, you must develop a solid trading plan that covers your:

- Risk management - with extreme emphasis on your risk to reward ratio
- Trade execution
- Money management
- Trading performance and records

This will be very similar to the same trading plan you would develop as a pattern day trader, though there are some important differences. First, you must adjust your risk-to-reward ratio to lower your risk tolerance. For example, if you use a 4:1 ratio, then you could lose three out of every four



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Key Points:

- **Small account holders must, by necessity, risk more capital per trade**
- **Compensate for this by lowering your risk tolerance in other areas**
- **Closely manage your stop-loss for each trade**

trades and still preserve your capital. Anything above that is your trading profit.

You will also, by necessity, need to use a higher percentage of your capital for each individual trade. A significant number of day traders works on a maximum of about 2% per trade, but for small account holders this is not practical since your profit target will be too high to reach consistently, or your gains will be eaten by commission charges. This will be discussed in greater detail in the "Pitfalls" section below, but it is important to emphasize here that the more capital you use per trade, the higher your overall risk. You must compensate for this by using a trading system that must meet higher standards for signaling a trading opportunity and by carefully managing your stop-loss.

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Key Points:

- 90% of beginner traders are wiped out within three months
- Developing a detailed, long-term trading plan will help you survive
- The key to success is FOCUS!

Developing Your Trading System

This document will not go into great detail about developing a trading strategy since most of that information is already covered in other Trading EveryDay e-Books (for example, the Trading Plan Planner and the Day Trading Strategies series, both by Leroy Rushing). The basics are the same, though the execution and planning will be slightly different for the small account trader. The following information is a brief introduction to creating your strategy.

About 90% of beginner traders are wiped out after the first three months. The primary reason is because they walk in unprepared: they try to "wing it" with no long-term plan, no trading strategy to get them there, and no tools essential to a successful trading career. It's no wonder that so many traders get eaten alive! Just by reading this e-Book, you will have already reduced some of your risk. Nonetheless, it is still a long road to follow.

The key to successful day trading is FOCUS:

- F** - Form a solid trading plan with realistic goals
- O** - Outline a strong strategy to meet those goals
- C** - Change strategies if you are not reaching your goals
- U** - Use and improve your trading skills constantly
- S** - Stay in the game!

At a high level, this means defining your long-term goals, developing your overall strategy for reaching those goals, creating a strong money management plan, and defining your risk tolerance. It also includes such things as determining your approach to day trading and what type of chart analysis (gap plays, etc.)



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Key Points:

- **Incorporate your risk management plan, money management plan, trading strategy, and trade tracking system into one solid "game plan"**
- **Plan to lower your risk tolerance for each trade to compensate your added risks as a small account holder**
- **It may take weeks or months to properly prepare -- paper trade to refine your game plan further before risking real capital**

you will use to generate profit on your capital. Perhaps most importantly, your plan should include how to record and track your trading history, how to review and adjust your trading plan as needed, and what measures you will take to protect your capital if you start losing too many trades.

Your trading system needs to incorporate all of this into one "game plan" that you will use when you are actually trading. If you have a low risk tolerance, you will have a lower stop-loss threshold, a smaller profit target or time frame, etc. Depending on the trading style you plan to use, you need to define the parameters of your chart analysis and determine what criteria you will use to build your weight of evidence. Additionally, you have to decide how each trade will be recorded and how to analyze your own trades to improve your technique.

As a small account holder, you will have to plan a very low risk tolerance when calculating all of these values because your risk is already high. By simply considering the concept of economies of scale, you are forced to risk more of your capital during each trade, pay a higher percentage of your profits to commissions and other fees, and risk a higher percentage of profits to slippage. Obviously, you will need a very conservative trading plan to adjust for this inherent risk - and the discipline to stick to your plan once you get started.

Whether you are a small account holder or plan to become a full-time Professional Trader, it pays to prepare weeks or even months in advance. Research your trade, find the tools that you need, and become comfortable with your technique. As always, paper trading is a good idea before you start applying your trading plan "live" in the real markets. Fine-tuning your strategy and your technique on paper will help keep you in the game for the long run.

Before you develop your plan, you must decide which market you want to focus on. There are two avenues to consider as a small account holder, both with pros and cons, which may lead you to the success you are looking for. These are Sporadic Day Trading and E-mini Futures Trading.

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Key Points:

- Day trading just three times in five days will not trigger the \$25,000 account minimum for pattern day traders
- Increase your reward-to-risk ratio so that you find and initiate only the high-odds trades
- Continually analyze your trading record to sharpen your technique

Sporadic Day Trading

As previously stated, the Securities and Exchange Commission (SEC) defines a pattern day trader as anyone who opens and closes a position four times within a five-day period. Any trader who goes above this threshold triggers the mandatory \$25,000 account minimum, and his or her account is frozen from trading until that minimum is deposited.

It is important to note that some brokers will warn you if you are about to break this threshold before you make a trade, while others will not. Once the account has been triggered, it cannot be reversed. If you choose to engage in what we call "sporadic" day trading, we highly recommend that you track your trades yourself without relying upon your broker to give you any warnings. After all, tracking just three trades in five days should not be that taxing for the Professional Trader.

As mentioned in the "Challenges" section above, you are exposed to increased risk as a small account holder. You must risk a greater percentage of your capital with each trade, you have less room for losing a number of trades in a row, and you have less trading opportunities because you must build a stronger weight of evidence to avoid losing. You must also lower your risk tolerance and increase your reward-to-risk ratio (for example, 4:1 instead of 2:1 or 3:1) to compensate.

Sporadic day trading, perhaps ironically, can actually help you reduce your risks. If you can only trade three positions per week, you have the time to find the high-odds trades. You are also forced to step away from the market more often, allowing you the time to analyze your trades and sharpen your technique.



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Key Points:

- Use the time between real trades to practice your strategy by paper trading
- Small account holders must be highly disciplined and stick to the trading plan to avoid catastrophic losses
- With patience, you can build profits incrementally and stay in the game

If you are a beginner trader, you can use this time to paper trade, hone your skills, and develop a strong trading plan for when you have the capital to become a full time day trader. Then, when the 4:1 trade (or whatever your identified high-odds ratio) appears, you are ready to initiate trading.

Again, it is important to remember that you are at greater risk of losing your capital as a small account day trader than if you weren't. Although the temptations to veer from your trading plan are the same, there are greater consequences for small account traders. For this reason you must be extremely disciplined and keep to your trading plan.

With patience, you will be on your way to building profits if you lower your risk tolerance, create a strong trading plan, and do not veer from your strategy.

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Key Points:

- E-minis are trading products developed by the Chicago Mercantile Exchange (CME)
- E-minis indices track the futures and options values of stocks in their corresponding stock market indices
- Same trading principles apply (need a strong trading plan and stick to it) but trading indicators will be different

E-mini Futures Trading

Futures and options are complex concepts. Very briefly, an option is a contract to buy a named financial product (stock, index, etc.) at a named price on a named date. Profit and loss comes from the relative price difference between the option and the financial product price on the closing date. For example, if you have an option to buy Company XYZ for \$35 and the price of the actual stock is \$40 on the closing date, you stand to earn \$5 per share with that option. But regardless of the price, you are obligated to purchase that product.

Options, as the name implies, allow you to pay for the option to buy the financial product. If the price of the product is below the "strike" price on your option, you can choose not to purchase - though the money you paid for that option is lost. Both futures and options can be traded like stocks. And, as you might expect, the value of futures and options generally follow the value of the financial product (though they become worthless in and of themselves on the closing date).

In 1997 the Chicago Mercantile Exchange (CME) began to create stock indices to track the price changes of futures and options and introduced a new investment product called CME E-mini futures. These products are linked directly to its corresponding futures index, which is in turn linked to the stocks on the actual index. For example, the E-mini S&P 500 Index tracks the combined value of the futures and options of stocks on the actual S&P 500 Index.

The same principles apply to day trading E-minis, but the techniques used are usually different. You still need to create a solid trading plan, establish your risk management, and



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Key Points:

- **Big pro and con is that E-minis are highly leveraged -- you can actually lose more money than you have on the table**
- **Pro: can build profits faster; Con: poor risk management can wipe you out quickly**
- **Search for high-odds trades and set a low stop-loss to manage your risk**

devise a trading strategy, etc. However, you will follow different indicators in your chart analysis as you build your weight of evidence and identify the high-odds trades. Even those experienced in stock market trading should follow and study the futures index they plan to trade on for weeks or even months before entering the market to note the patterns and develop a strategy.

The big advantage to trading E-minis for small account holders is that the margin requirements can be much lower than that of the stock market. Minimums vary by futures indices (and brokers may require higher minimums) but, for example, the E-mini S&P 500 Index requires a margin of just \$3,500 in your account to trade. All indices are traded almost 24 hours per day Monday through Friday, are traded electronically, and are highly liquid with very high volume - about 1 million contracts traded per day.

Purchasing an E-mini unit is relatively easy as well. Again, the unit price varies from index to index, as does the minimum price fluctuation (tick). For the E-mini S&P 500 Index, each E-mini costs \$50 x the current index value. If the index value is 1000 for example, then the cost of that unit would be \$50,000.

However, as a trader you would only be required to cover a certain percentage of the contract. Futures have always been extremely lenient when it comes to margins - on a \$50,000 S&P 500 E-mini, you would need less than \$5,000 in your account.

This can also be the biggest disadvantage of E-minis: higher leverage could mean higher risk of losing all (or even more!) of your capital. Trading on the futures market is notorious for wiping out investors who take on too much risk.

Luckily, you can control your risk by searching out the high-odds trades and most importantly, by employing stringent stop-losses. On the E-mini S&P 500 Index, each point is worth \$50, and the minimum tick is .25 points or \$12.50. If you have \$5,000 invested in an E-mini and you set your stop loss at 3 points, then the most you will lose is \$150 in the trade (plus commission fees). In theory, you could lose a lot of consecutive trades and still have available capital.

If you have a strong trading plan, a good strategy, and a good set of

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Key Points:

- Number one goal in any trading plan: Preserve Your Capital
- Research E-minis and become familiar with them before you start trading

trading techniques, leveraging in this manner can yield great results. Closing your position after a conservative movement of just 3 points will bring you a fairly good return of 3% per successful trade.

We cannot stress enough that your highest priority is to preserve your capital. In the case of highly leveraged trades like futures and E-minis, it is especially important to be disciplined in your approach. One rash move could cost you your capital and more.

With a carefully planned, well-disciplined approach that minimizes your risks, trading E-minis can be quite profitable.

Find out more about these and other CME products at their website: (<http://www.cme.com>)

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Key Points:

- For sporadic trading, never risk more than 50% of your capital for any one trade, and plan to use 10 - 25%
- For E-minis, balance your unavoidable leverage risk by using low stop-loss points and engaging in high-odds trades
- Do not initiate multiple trades

Pitfalls to Avoid

For many small account holders, the temptation is too great to try to make money faster. Unfortunately, as we discussed above, it is better to take less risks and build your profits incrementally to ensure that you preserve your capital first and foremost. Don't swing for the fences!

One of the first pitfalls that beginners make is to trade using too high a percentage of their capital, or to leverage their margin accounts too heavily. Most day traders prefer to risk 2% to 5% of their capital per trade, but for the small account holder this is not always practical.

For sporadic day trading discussed above, do not use more than 50% of your capital for any trade, and plan to use much less (about 10%-25%). If you do get into the higher percentages, make sure you reduce your risk tolerance accordingly.

For E-mini trading, leverage is unavoidable. You can reduce your risks by only entering high-odds trades and a very low stop-loss threshold.

Along that line of thought, do not initiate multiple trades. Again, since you are only able to make three trades per week using the sporadic day trading method, increasing your risk in one (or more) trades by tracking multiple trades does not make any sense, especially for the beginner trader. Also, put aside any paper trading you are doing once you initiate a real trade. You do not want to lose real money because you are too distracted by a simulated trade.

Another possible pitfall for stock traders is to start trading stocks



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Key Points:

- Sporadic day traders should not trade lower-priced stocks, especially penny stocks
- Don't try to "cash in" on consecutive winning trades by using more capital or otherwise doing things outside of your trading plan

with smaller prices. On the surface, this sounds like a great idea since you are able to purchase more stocks with your limited capital. Let it be known that there are many flaws to this logic. The first is that stocks with lower stock prices also tend to have lower value swings and momentum. A \$10 stock, for example, may move half a point either way on a good day, but a \$50 stock could move several points. Moreover, higher priced stocks tend to follow day trading patterns more consistently so that you can mark your opening and closing points with greater accuracy. This in itself will reduce your trading risk.

It follows then that you should avoid penny stocks like the plague. Not only are they nearly impossible to predict through day trading methods, but worse they are affected by "artificial" factors like unscrupulous brokers, pump-and-dumpers, erratic volume, and even trade freezes. Simply put, day trading penny stocks is the best and fastest way to put yourself out of business. Stay with the more established stocks that are more likely to follow price patterns.

Finally, don't follow the temptation to run with success. Two, three, or five winning trades in a row does not mean you should increase your risk tolerance, use more capital, or otherwise try to "cash in" on your winning streak. Not only can you easily wipe out your hard work with just a couple of losing trades, you can actually put yourself down very quickly. Stick to your trading plan until you have met your

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Key Points:

- International markets that do not have account minimums can be profitable, but also have currency and political risks and are harder to access
- There are other avenues like currency trading which you may want to explore, though this is outside the realm of day trading

trading goals, then re-evaluate accordingly.

Other Day Trading Options

Trade International Markets

Like trading futures, trading on international markets comes with its own set of pros and cons. The SEC has no say over the regulations of stock exchanges in other countries, and most do not have minimum account levels to begin trading. In other words, you are free to day trade as much as you like.

However, there are many cons to this method as well. First is the difficulty of accessing these markets. There are brokers you can find on the Internet that can help you connect to overseas markets, but it is not as easy as setting up a normal U.S. trading account. You also expose yourself to currency risk and possibly other risks associated with trading in a foreign country. You should fully research not just the stock market regulations, but the conditions within the country itself before you decide to take these risks.

Other CME Products

The Chicago Mercantile Exchange (CME) offers other products that can be used for day trading as well, including currency markets and even weather patterns. We do not recommend these avenues - these products are, in our view, getting away from the spirit of day trading stocks - but



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Key Points:

- Preserving your capital should be your number one goal
- Sporadic day trading and trading E-minis are good options for small account holders
- No matter what your trading plan, heavily research the markets and products you will be trading, and paper trade to fine-tune your strategy before risking real capital

it is an option that you may wish to explore.

Summary

SEC regulations requiring that pattern day traders must have a minimum \$25,000 in their accounts presents a challenge to beginners and small account holders. However, these challenges do have their solutions.

The most important thing for small account day traders to remember is that preserving capital is your number one goal, and that you have less room for error. A relatively short string of losing trades, over-leveraging your account, and chasing winning streaks can lead to disastrous results. For this reason you need to develop a stringent trading plan that lowers your risk tolerance. Using this method you will need patience to build your profits incrementally, but it gives you your best chance at long-term success.

There are other options available as well that are worth considering. Day trading E-minis exempts you from pattern day trader status and the \$25,000 minimum. Likewise, trading on international stock markets that do not have minimum account regulations can open up the door to opportunities. You must understand that these options come with their own risks, which should be thoroughly evaluated before you decide to incorporate them into your trading plan. Also, remember that these options will require you to adapt your trading strategies to address the forces affecting that particular market.

If you do your research and paper trade your strategy before you start using real money, you will reduce the risk of losing your capital and create day trading opportunities for yourself. Although small account day trading requires more patience, with time you can build your capital to the point where you have the ability



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About Leroy Rushing Jr.

With two Master's degrees in Business Administration (Finance) and Science (Statistics), professionally trading stocks is almost a natural vocation for me. By applying my knowledge of business and mathematical principles to the stock market, I found that I could reduce my investment risk by "deconstructing" a stock using chart analysis and market indicators.

But it wasn't always a walk in the park. I found that there are other variables, like the emotional and mental state of the trader, that play a large part in the trading process. I've developed a plan that helps traders find the right trades, and find the courage to make the right decisions.

In my previous corporate life, I was also responsible for providing leadership and training to others in the company. That extensive experience has become the basis of my coaching program today.

I encourage you to [contact me](#) with any questions you may have about my products or services. And don't forget to [register for a Free Consultation/Training Session](#). I will give you the guidance and support that you need to improve your knowledge, skills, and mental focus for higher profitability.

Leroy Rushing, Jr.
TradingEveryDay.com
leroyrushing@tradingeveryday.com
(408) 821-2895