WALL ST. CHEAT SHEET

We've got the Word on the Street

Q&A Series

Pro Trader: Brian Shannon

A champion poker player abides by several concrete rules including: 1) know when to fold, 2) know your opponent, 3) bet the proper size, and 4) push your advantage when you have the best cards. Similarly, professional independent trader Brian Shannon uses discipline and risk-management to consistently win in the markets.

Brian is one of my trading mentors. I spent a few years following his blog and ultimately his book *Technical Analysis on Multiple Timeframes*. During that time I learned what Curtis Faith meant when he said, "One of the ways great traders distinguish themselves from average traders is by their ability to adhere to methods." Brian's methods are clear and simple. Like a great trainer, Brian perpetually brings the wandering students back to the basics. He reminds us we are playing a game of probabilities and if we confuse this point, we cannot be successful over the long term.

I firmly believe that twenty years from now when we look back at this Golden Era of Day Trading, Brian Shannon will be one of the faces and voices that will define this space and time. He is both a true student and teacher of the markets who can teach you to be a professional trader *if* you have the right combination of skills and discipline.

I recently had the chance to chat with Brian about his career, his Premium Service at StockTwits, his advice for traders, what he looks for in successful traders, and how his best and worst trades affected his career. So, let's deal the cards and see how the master plays our hand ...

"Only price pays." ~ Brian Shannon

QUICK STATS

PROFESSION:
Professional Trader

HOMETOWN:
Denver, CO

AGE:
41

EDUCATION:
Bachelors in Business Management

PUBLICATION:
Technical Analysis on Multiple Timeframes
Brian Shannon

RECOMMENDED BOOKS:
The Daily Trading Coach
Dr. Brett Steenbarger

Secrets for Profiting in Bull and Bear Markets
Sam Weinstein

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Damien Hoffman: Tell me a little bit about that sweet rush with trading and you became addicted and you knew you were hooked?

Brian: The first time I got that needle in my arm was when I was about 14 or 15-years old. I was living in Boston, Massachusetts. At the time Boston was the car theft capital of the world. There was a local company called LoJack trying to come up with a solution. I saw something on the news about the company -- how they were giving away the tracking units to the State Police. I had been watching Wall St. Week with my Dad for a couple years, and I finally said, "Dad, would that be a good stock to buy?" I had some money saved from different jobs I did as a teen. He said, "Yeah, let's invest." I told him I had $500. He said the stock was at $4 and he'd put up the rest of the money so I could buy 1000 shares.

Long story short, he gave me the leverage -- I didn't realize it was leverage at the time. We bought 1000 shares and the stock went from $4 a share to $10 in about 3 or 4 months. As a teen, I thought I was going to be rich beyond my wildest dreams. I thought, "Why would anyone ever get a normal job when you could just do something like this that is obviously so easy?"

Damien: Do you feel as though you have not had a regular job since you've been a trader?

Brian: Not exactly. I have had regular jobs. I started in the industry as a retail stock broker. In my mind that job was a glorified telemarketing position rather than a job in high finance. I've had a number of brokerage jobs. Then I worked as a proprietary trader, managed a proprietary trading desk, and managed a small hedge fund for period of time. So, I've had little detours along the way, but I always consider myself a trader first and foremost.

Damien: I've noticed a theme in my interviews with traders. Many of them started because they thought it looked easy or did well on the first few tries. At what point did you realize trading required a lot of effort to be successful?

Brian: I had always been attracted to momentum names. And, I had experienced some heart breaking losses along the way that brought me back to reality. To survive in this game is difficult for people because our emotions get in the way. But, if you do the work -- which is *hard* work -- and you're disciplined, then there is an equal chance for all of us to succeed.

As far as daily preparation goes, it really begins a little bit after the market closes. I might go exercise or something, then come back to my desk for a couple hours. I usually look through 150 or 200 different stocks and ETFs. I like to get a feel for set ups with the potentially lowest risk yet high probability of profits.

It's a process of elimination to go through the charts on a lot of different time frames and try to imagine different scenarios: good and bad. Then I develop a risk-reward proposition and check if earnings are due out. So, that's the evening routine. Then, about an hour and a half before the market opens, I'm sitting down, going through some emails and looking at some headlines. I don't read the news much -- just the headlines. I'm trying to see what's shaping the sentiment of the day. I want to see if there is any unusual activity with the stocks I was looking to trade. I set alerts, write notes in front of me as little reminders, and try to get into that zone for the open. I make sure I have a plan of action so I don't become just a reactionary participant -- which I think a lot of people tend to do.

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Damien: Sounds like you had great training and experience. At what point did you decide to leave the prop trading firm and go out on your own?

Brian: I left the retail brokerage industry in '93 or '94. At that time I became a proprietary trader for a firm in New York. That meant I had to put up $25,000 and they would give me 10:1 or 20:1 leverage. There really wasn't much support. They made me call in my orders because the internet was still 28K dial-up -- 56K was the *big* deal. Prior to that I had scraped together $25,000 and was trying to build a little cushion. I was trading a stock that had this miracle wrinkled cream which cured all wrinkles [*both laugh*]. I traded it over and over again. Then one Thursday evening I left a position open over night. I blew off the next day of work to go skiing with my Dad in Vail. Before the market opened I called the office to see where the stock was trading. It was halted! The company was being investigated because they had a bullshit product that didn't work. The FDA shut them down.

Obviously I got hit with a major mental blow. There I was about to be a proprietary trader in the next two weeks and I just got hit hard. I thought, "This is going to be tough." So, I persevered and went through with it anyways. Since that first day I worked as an individual trader. I had a small hedge fund for a while, but the numbers didn't make sense. The fund was about a million and a half dollars, so I don't think you could call it a hedge fund. Then I ran a day trading office. From there our business got bought out by MarketWise, a local competitor, who was involved in trading and investor education. I went to work for them. I developed courses and traded as a proprietary trader for MarketWise. I developed some software and did a lot of different things. They always gave me a good amount to trade with as well.

Then, about three and a half years ago I started doing a daily blog to help keep my thoughts fresh. At MartketWise I had also written a daily newsletter. Writing was really good discipline for me to organize my thoughts and think about what might happen the next day. So, I started the blog to keep my good habits flowing. Then I slowly built up the blog to the point where it made sense to monetize. I partnered with StockTwits to accomplish that.

Damien: You and Joe Donohue -- Upsidetrader -- were the centerpiece of core growth in the very beginning at StockTwits. Can you tell me about your experience and the value you see in StockTwits?

Brian: At first, I was a little skeptical of StockTwits. When Howard Lindzon approached me with the idea, I thought, "I don't know. It could be like a Yahoo! Message Board and if I want a friend I'll get a dog." [*laughing*] I didn't expect to see such high quality people on StockTwits. It's really a positive platform. People call things honestly. Everyone makes mistakes and if you do them out in the open, people will see that and trust you more. It's great to find people who are similar and also somewhat different from my approach. I like to get different perspectives.

The danger for newer people is to blindly follow others into trades. That can be a concern. For example, I'll say I bought a certain stock and later I'll tweet I sold it for break-even. Two days later someone will email me and say, "Hey, I'm still holding that stock. What do you think?" I'll try to be as polite as possible and say, "You're on your own. I told you I got out of that stock." So, the danger is that people just blindly follow others. Regardless, StockTwits a great source for identifying symbols you might not normally look at, getting some news, and great links to real fascinating stories.

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StockTwits is what you choose to make of it. The people I follow have chosen to take it seriously. They put forth a positive effort which makes it really exciting for me. Also, StockTwits TV gives you a lot of great views where it's more than just 140 characters. You can get a full dimensional aspect.

Damien: Who do you follow on Stocktwits?

Brian: I've found some good traders and good friends on StockTwits. There are also people that fit into both of those categories such as Joe Donohue (Upsidetrader), Todd Stottlemyre whose skills as trader I respect a lot, TodayTrader who does a great job, SMB Capital is a professional trading firm with consistently valuable insights, and AnnMarie2006 has a great head on her shoulders. There are a lot of others I follow, but those are the core.

Damien: Brian, you have seen and taught many traders. What are three of the most important things you think every trader must learn to be successful? On the flip-side, what are three of the most common mistakes every trader must avoid?

Brian: First, successful traders must have flexibility in their opinion. The market doesn't care what you or I think about a stock. The market is going to do what it does. Things will happen that seem very irrational. So, you just have to be prepared for anything. You must have a back up plan for every situation.

Second, keep your analysis fairly straight forward and simple. By that I mean understand the market structure and then learn to trade the stocks that match your personality in terms of price, volume, and that sort of thing.

Third, at the end of the day, it's only price that pays. Everything else is just opinion. Even if it comes from the President of the United States, George Soros or anyone else, the market will show their opinion is wrong at times. So, if you blindly hold onto something because of your belief of ego, you can get run over and then backed up on.

Insofar as mistakes, the first is trying to master short-term trading before understanding longer-term fundamentals. Basically, trying to run before you learn how to walk. You have to go into it slow. The market will be there. But people have to slow down a little and not try to get rich on every trade.

Second, realize that you're going to make mistakes. If you can cut those losers quickly, you'll keep those losses small enough to come back the next day. There are always more opportunities.

Third, right now a timely mistake is not understanding what they're trading. Leveraged ETFs are a perfect example. To this day I am shocked I get horror stories emailed to me about people who are still holding FAZ and not understanding why they haven't broken even yet. So, understand what it is you are trading and be aware of the leverage.

Damien: When I interviewed Mike Bellafiore from SMB Capital, he talked a about how his firm screens for candidates who have the characteristics of a good trader. If you were screening candidates to start your own trading firm, what would those screens be looking for as both strengths and weaknesses?

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Brian: Obviously, you want somebody who is smart -- someone who has the horsepower to understand the markets. But, not necessarily the MBAs. They don't always make the best candidates. I prefer street smarts -- someone who is a bit of a hustler and quick on their feet. If I was interviewing a candidate to come trade my money, I would also want to know that he or she has the ability to change their opinion when they see evidence mounting that they are wrong.

I think a good way to judge some of those things is to go out drinking with someone and see them get their guard down. Then they will reveal who they really are. If they can maintain their clever wit, I would be impressed. Another test would be to go driving with them -- and *not in that order*! I'd like to see aggressive drivers who can successfully drive through traffic and various things that get thrown up at them *without* endangering anyone. I'd like to see someone who is anticipatory in their thought flow. For example, if they see a light turning yellow, do they have enough time to make it safe or should they start slowing down. What is their instinct? Do they stop at every yellow light? Or, do they go for it on some of those when it looks safe. That's oversimplifying it, but I think they have to be anticipatory and driving could be a good way to effectively measure it.

Damien: Moving on to some more trading specific topics, I want to discuss the Volume Weighted Average Price (VWAP) indicator. My lessons with you taught me about VWAP. Can you explain why VWAP is important yet remains underutilized by individual traders?

Brian: VWAP gives us a benchmark of value throughout the time period a trader references. On a one-day timeframe, VWAP tells us who is in control -- the buyers or sellers. If VWAP is rising throughout the day, then buyers are firmly in control. So, there is no reason to short that market. If VWAP is falling throughout the day, then sellers are firmly in control. So, there is no reason to buy that market. VWAP is a great way of looking at supply and demand as it changes throughout the day.

VWAP is underutilized because it's still not known well or offered by many places. Until recently, VWAP has been considered an institutional tool. So, most people haven't found enough information about how to use it. However, I am starting to see it available more often and discussed more each day, so that is changing.

Damien: Brian, if you were hanging out with another pro trader who asked what are the one or two most important lessons you have, how would you answer?

Brian: All of my secrets to success are in my book. But in that situation I would say to focus on the cyclical rhythms of capital through the markets on all timeframes. Then, learn how to understand the way each timeframe fits in with another. The long-term trend is nothing more than a bunch of shorter-term trends. So, the short-term trend leads the long-term trend. You have to understand that different participants come into the market at various levels and timeframes.

The market is always a moving target. However, if you can understand who is doing what -- rather than memorizing patterns -- you will be successful. Put yourself in an investors shoes and ask, "How would you feel if you were a swing trader or day trader at this point on the chart?" Then you can think about the cumulative perspective of the market and support it with the lines and bars on our charts.

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Damien: You mentioned trends. I've also noticed you have a great nose for sniffing out trends. As you know, the conventional wisdom says that once something reaches the headlines, you're too late. At what point do you get involved with the trending stocks?

Brian: I understand the fundamentals of a lot of companies. It's a fine balance. For example, I've traded the stem cell stocks over the past few election cycles. Bush was going to veto them and Obama promised to give federal funding to stem cell companies. So, watching the television and headlines made me realize this issue was coming into the public perception. Then I look at the charts to see whether the stocks have already made a move. If they have, I will dismiss them. If not, I will start stalking the stocks and wait for evidence that larger players are accumulating the shares. Then I will establish positions as the stocks start to break out before big volume starts coming in.

But you have to be very active and attentive. In the case of stem cells, the stocks plummeted the day Obama signed the bill. It was a classic case of "buy the rumor, sell the news." The problem is these companies are years away from making money or bringing things to market. Ordinary investors at home don't recognize this. They just think, "Wow. That's great news. I'm going to invest because maybe it can cure diseases." This person is going to be late to the game if they are investing this way. Unfortunately, it's simply a matter of not understanding how the stock market works.

Damien: Brian, what is it like to become such a successful trader outside the traditional system? Do you ever dream of running a fund or trading a book for a huge financial firm?

Brian: Definitely. The first time I ever heard of George Soros I fell in love with the idea of getting wealthy doing such an interesting thing. It's something I will look at in the future because my current projects still require a lot of attention. Even at 41-years old I am still young in this business. I hope the opportunity will be there a little later down the line.

I'm not very interested in all the back-end, administrative stuff. So I'd probably be a much better partner for someone who wants to manage that part.

Damien: We took some questions for you from our Twitter followers. A frequently asked question was to share your best trade and worst trade. Do you mind sharing?

Brian: I don't mind at all. My best trade was a sector trade. Back in 2001 I recognized that security stocks would be more important in an increasingly unsafe world. So, I identified about a dozen companies -- many of which are no longer around. I have always been a fairly conservative trader. I don't usually swing for the fences. But at this point in time I had deep conviction these stocks would rally. So, I presented the thesis to my boss. I asked him for additional buying power to take advantage of the opportunity. After I got the necessary approval, I loaded up on five different companies and rode the trend perfectly. The prices kept running higher and the stories got bigger. I made more than one trade, but it was a memorable score.

Fortunately, on the negative side, I didn't load up and explode. I have two "worst trade" stories. One is already on my blog, so I'll share a different one. Back seven or eight years ago, the company Taser went on a run. Some days the stock could move 10 or 20 points. Then it was splitting

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and running again. Well, one day I thought, “This has got to be it.” So, I went to sell the stock short but there were no shares to borrow. Unlucky for me, I found Taser warrants. Since there were no restrictions to short them, I decided to trade those instead.

I started my trade very conservatively with smaller batches of shares. The stock would drop 10 points in a heartbeat and I thought, “I got it! I rode the stock on the way up, now I’m going to be the master of the warrants on the way down.” Then one day I shorted a few hundred shares and they went against me a couple points. So, I decided to add to my position and short a little more ... and short a little more ... and short a little more. Before I knew it I was down about $15,000 or $20,000 on the day.

As a result of my experience, I have the strongest conviction that you really need to trade the trend. You can catch little blips in the opposite direction, but you must stick with the primary trend.

Damien: A lot of traders deal with the dreaded deer-in-the-headlights moment when things spiral out of control. At what point did you know you had to pull the rip chord to prevent a career ending experience?

Brian: In both my worst trade experiences, I exited because it was the end of the day. The financial damage was horrible and I knew I would beat myself emotionally later. I didn’t want to then lose sleep worrying that the stock would open the next day and continue going against me. So I say, “Rip the band-aid. Feel the pain. Move on.” Don’t compound the problem by drawing it out over time. Once something goes against you, you have to accept that you’re wrong and move on. You must start trading real small and recovering your loss -- a couple hundred bucks at a time. It feels insignificant. However, you never want to try to get it all back at up on five different companies and rode the trend perfectly. The prices kept running higher and the stories got bigger. I made more than one trade, but it was a memorable score.

Damien: Brian, this has been a real treat to review this great trading wisdom. Thanks for taking the time and I look forward to speaking with you again soon.

Brian: Thanks, Damien. You guys are building a great site and I’m glad to talk with you anytime.