Maybe you've heard the expression: "Catching a Falling Knife"? Well, today over we had just a trade.

As a matter of fact, there are usually at least a few of these every week, and dozens more if you consider the low market cap crap pink sheets or over the counter garbage. If you love those small cap pump and dump stuff, pay attention to this post carefully.

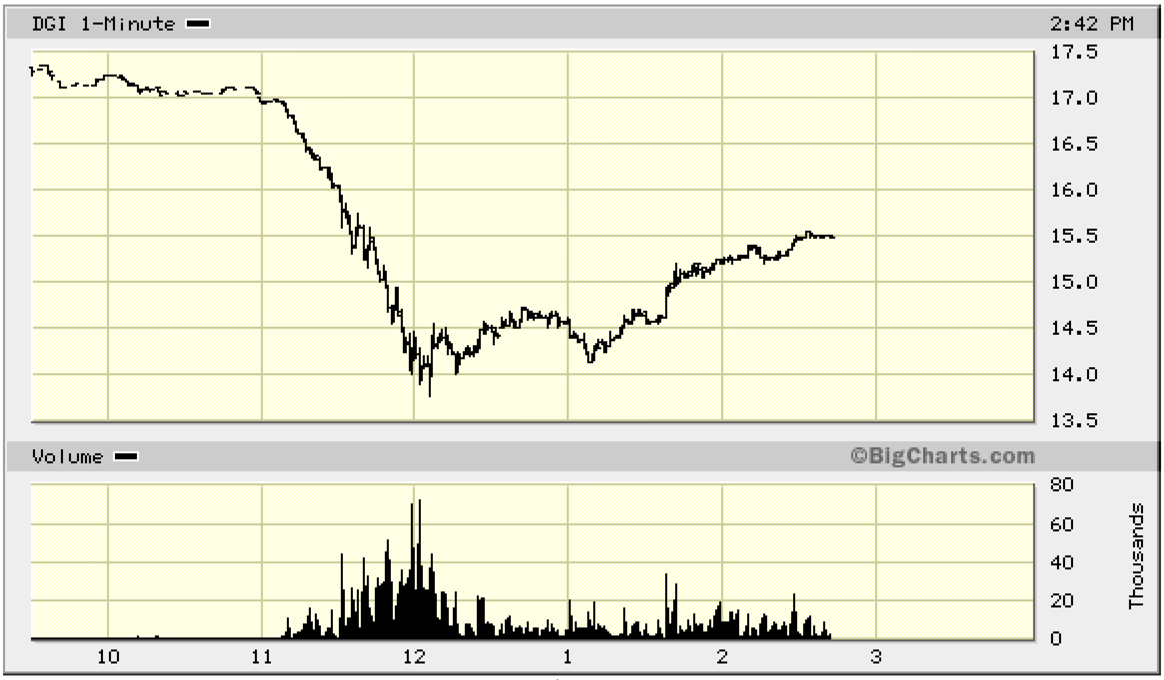
When a stock is falling hard and fast like $DGI today, trying to 'catch' it by guessing the bottom is like trying to 'catch a falling knife'. It **will** cut you. Expect it, especially if you move in eagerly too early.

Does that mean you shouldn't play them? Well, most would say yes. I would say these type moves provide exactly the volatility day traders are looking for. Why? I will tell you **how** to play them safely so you won't get burned and how you **can** profit from them

So, Yes they are dangerous… Yes you are likely to get stopped, sometimes several times if you are impatient. But the pain is often worth the risk… **IF** you play it right.

Here's how to play it right… and then I'll show you how you can do it sometimes with no pain at all.

Wednesday, February 15, 2012 - DGI – DigitalGlobe Inc



Above is a one minute intra-day chart of $DGI. Below is 5 minute.

At 11am this stock started to move down as visible in the top half of the chart (that's the price of the stock)… volume picked up (that's the bottom half of the chart).

You will notice that volume kept on increasing faster and the price of the stock kept on falling faster. Why? Who cares, but seriously I'm not going to give you that much information right now, especially because as a day trader, it's usually best to focus on execution rather than analyzation.

Yes, there are steps you need to take before trying to catch the knife, but you can assume that my feed will generally provide some guidance and due diligence to avoid the ones that have little to no chance of rebound. If we are writting about them, it is because we believe there **will** be a rebound, otherwise we will tell you to stay away.

The fact that it was dropping fast is often due to a news event. In this case, there did not appear to be any. So far so good. Let's Play.

I first tried to catch this knife buying 1,000 shares at $15.33. Now, if you are going to do that, then you best be prepared to exit fast if you are wrong, expecting the volatility to continue. Initially, I put in a stop of 40 cents, because I like to give things a chance a bit under round numbers like 15.

If you look at the 1 minute chart you can see that it then went up a bit. But as soon as it retreated and started to go below my entry price I knew instantly that the bottom was not in, so at that moment I changed the stop order to 15.13 limit and waited to see if it broke below 15.2 to hit enter. First knife catch attempt resulted in loss of $200.

That's what I deserved for my impatience. For my next attempt, I decided to increase the risk $ amount because the reward potential is also increased. New strategy risk total $600.

So, I put in a limit order to buy 500 shares at $14.6, with the strategy being to scale in, meaning to buy in smaller pieces, as it is moving in price as it falls and forms a bottom. Essentially, it's like dollar cost averaging.

Here, I can continue to add to this position until it reaches my stop loss total amount of $600 which at that point I would immediately have to get out of the position and sell ALL!

As it was moving fast, and as is usually the case with these type moves, they love to test the resilience of traders by breaking round numbers. That is, I instantly knew this thing wanted to break 14. Did I know for sure that it would? Of course I didn't know that, which is why I was scaling in.

By the way, these fast drops typically go for about 30 – 60 minutes.

So, because of the speed of the move, it's best to wait **at least** 5 minutes before buying again, and I did… I bought another 500 shares at $14.2. Now pay attention…

I did something that comes with experience, or stupidity, or both, but anyway, what I did was I changed my maximum acceptable loss on this scale in play to $1,000. Why would I do that? Don't I teach NOT to lower the stop? Yes, I do. But there is always an exception to that rule and these type crazy drops often make me reevaluate the risk/reward ratio in real-time. Should you do that? Probably not, and you won't have the experience to know… besides, better safe than sorry.

But aren't most of my intra-day picks rebound plays? Yes, most are, but again the answer to that is for subscribers only. Anyway, the majority of my rebound plays do not have the same volatility as these crazy movers, and therefore, they are more gradual and do not require any readjustments to the risk/reward ratio, so therefore, you are **not** allowed to lower the stop price and risk losing more.

Because they are not moving as fast, the potential reward does not change as much, therefore it does not make sense to adjust the risk level and change the stop price. Got it?

But why not? If I lower the stop price and risk more, isn't there a better chance that it will finally rebound and I won't lose money? No, that is not true for those plays. Again, why not? Because the % probability that they will rebound is not as high as these faster drops.

Again, why not? It just isn't ok!!! Seriously though, without over analyzing the situation, in simple terms it's like a rubber band.

If you take a rubber band and start to gradually pull it, you can do that for a long time (those slow gradual declines can go on all day long!). But if you start a gradual pull on the rubber band, and then increase the speed of the pull you will approach the maximum resistance level faster. Get it? 80% of the time these accelerating drops with accelerating volume spikes **hit the maximum resistance level of** the rubber band, and **do** experience a rebound.

What about the other 20%? Well, those break the rubber band and are the reason why having stops are **critical** in day trading. Usually there is an event that will cause those and we are **always** on alert for news just in case. (see $PPO from a few weeks ago as example).

At some price point, all the investors/traders in the stock who had stops help fuel the drop, but once they are out, and new traders like ourselves come in and start to build a position, if when it rebounds, all the sellers have now sold and traders like you and I are now buying, it will only help to push the stock price back up… meanwhile the other investors who did not sell (if they are watching), are nervously waiting to sell, but in the meantime, they are just watching (frozen) in panic.

Profitable, successful, Day Traders do not freeze! Most day traders do freeze, and don't sell fast enough, and don't keep proper stops to limit losses. Which is why you hear that 95% of traders are losers.

So why did I change my stop level again? Let me explain. When I first decided to start buying at $14.6 with just 500 shares, if the price did NOT approach $14 as fast as it did, then this play would've worked just fine and it would've formed a bottom soon after that first entry price, where I could've built on the position.

Again, think of a rubber band. At that price point bottom, the potential rebound is basically the same, just a smaller rubber band. If the price did stabilize just above 14 and then rebound to where it did ($15.5) I would've made a decent profit. But, had it instead produced a false bottom and retreated, depending on the speed of the new decline, I would've either sold some sooner or kept my original stop loss of $600 and lost that much. But, that did not happen.

What did happen? The speed of decline increased. The bottom did not come above $14. My initial thought was to buy in increments of 500 shares and buy about every 20 cent drop, but because of the speed and time, I had to reevaluate the risk/reward. The rubber band became visibly bigger and so an adjustment was worth it… **for me**.

But is it worth it for you too? Depends on your account size and your personal maximum acceptable loss. My personal maximum loss on any 1 day trade is $1,000.

So rule #1, as if you don't know by now: Set and **KEEP** a maximum acceptable loss. Don't have one? Good Luck, you'll need it.

You know I like to use a risk/reward ratio of at least 1 to 3. So, I was willing now to risk $1,000 for a potential reward of $3,000.

So, I waited to buy my 2nd 500 shares 40 cents lower than my first buy, so that was at $14.2, because it looked likely to break under $14. Then, I put a limit order to buy 500 more shares at $13.9. Now, at that time, I was done buying, and was now intently watching the total loss in my 'Positions' window such that if the total loss on this trade came close to $1,000, I already had an order to sell at market the **entire** 1,500 shares… just watching and waiting to click the mouse to enter the sell order.

If you look at the chart, you know that I never clicked on the sell button because the price did not go lower. Secretly, by the way, I would've preferred to get stopped out and reenter at a lower price with a bigger position, with an average price closer to $13. Why?

Bigger rubber band = bigger potential rebound = bigger profits.

After hitting the low of day just after 12pm it experienced a quick price jump, then a test near $14 again, but then it began it's rebound. After NOT breaking any new lows, the rebound became confirmed.

Does that mean 100% that it was real and not a false bottom? There is no way to tell… only price action would soon determine that, but as long as it does not break any new low, the rebound is confirmed.

So I added another 500 shares at $14.2, for a total position of 2,000 shares at an average cost of about $14.23. I would have added even more but became concerned about the slow pace of the rebound.

Again, think rubber band. These usually will rebound up sharply, then more gradually all the way to whatever price they were going to go to.

That initially was the case, but then a quick decline to retest the lows failed to break $14 and the rebound definitely was confirmed.

Now, pay attention. Had it broke below $14 and come remotely close to the current low of day, I was prepared to immediately sell 1,000 at market to reduce the risk. I would NOT have waited and let it go to my stop of $1,000! I listen to my God = price action. Then, the remaining 1,000 shares would've been immediately entered into the sell order and my eyes would've been glued to the total loss amount once again in preparation to reduce risk and prepare for a new, lower entry level.

The point here is: if even after you build a position and you think you may have got the bottom, only price action is the ultimate judge, and reducing risk is your mission! You can always accept defeat and buy back in again lower. If you play it right, you should be able to buy in even more (double or triple amount) to capture the larger rubber band.

Anyway, it did not break below $14 and did not come close to the low of day. At this point I should've bought more but again was not impressed with the speed of the rebound. When it reversed back down the 2nd time I was once again ready to bail. In fact, this time I set an order to sell at market 1,000 shares and was ready to click the mouse sell button if I saw it hit $14.1 to reduce risk.

It went down to about $14.17 then turned back up. This time, the rebound was for real. I sold 1,000 shares at $15.1 and the remainder eventually at $15.5 for a gain of $2,100 minus stop loss of $200 = total gain $1,900 on $DGI. Not bad. If it was a more typical rebound I would have felt more comfortable buying as it was going up and could've easily gotten my reward of $3,000+

Did I play this right? Yes and No. What could I have done better? I could have waited for a confirmed bottom instead of trying to catch the falling knife. But how could you know when that is?

Patience is key, and using a 3 minute or 5 minute chart helps in determining confirmed bottoms.

12:01 pm: “long $DGI <14 , be ready, i will give signal when is confirmed rebound and safe to buy”

12:08 pm: “$DGi confirmed rebound safer to buy now long”

12:28 pm “$DGI target 15.2 – 15.6″

If you had followed just those simple 3 trades today, and bought just 1,000 shares of $DGI around $14.2 at the time of our tweet, it would’ve used only $14,000 of trading capital and rewarded you with enough profit to pay for our service for the entire year with enough left over to treat your family to the most expensive restaurant in town, probably 2x.

Did you catch our $GNOM pick on Monday? We alerted at 9 am, again at the open, bought at $4 and told you it would go to $5. It did, and then some.