

Days to Cover – Best Strategies to Profit from Short Squeezes

Definition of Days to Cover

Days to cover is a formula which tracks the number of shares short in the market relative to the available float. This allows a trader to see how bearish or bullish traders are on a security. The last component of the ratio is the amount of daily volume. If you know the number of shares short and compare that to the average daily volume, you can estimate how long it would take for the short sellers to exit their positions. This ratio gives a trader a rough estimate of how much buying pressure is present in the market for a security.

Formula for Days to Cover

The below formula displays how to calculate the days to cover ratio:

$$\text{Days to Cover} = \frac{\text{Current Short Interest}}{\text{Average Daily Share Volume}}$$

Days to Cover Formula

Where to find Short Interest Data

Short interest data is tracked daily by the major exchanges, but is only released bi-weekly to the public. The best place

to find the days to cover data is <http://www.shortsqueeze.com/>. The site has a simple tool that works like a ticker where you type in a symbol and it returns the days to cover information and a number of other ratios. The beauty of this is you do not have to go to multiple websites to get the days to cover information from each exchange.

How to trade with this Information

The days to cover does provide some insight into the relative strength of a potential short squeeze. Stocks that have double digit days to cover ratios are often prime targets for speculators. But, traders have to realize that every stock that has been beaten appears ready for a bounce. To simply look at the days to cover ratio and buy the stocks with the highest number is a recipe for disaster. Traders have to not only look at the ratio, but also the technical formation which precedes your entry. If you see [climatic volume](#) and a sharp price reversal, odds are you may have a good entry.

Short Interest Table

Below is a short interest table for Federal Home Loan Mortgage Corporation (FNM). Notice how the stock had a days to cover value of 9.21 at the end of May which ultimately led to a swift sell off.

FRE

Federal Home Loan Mortgage CorporationNYSE

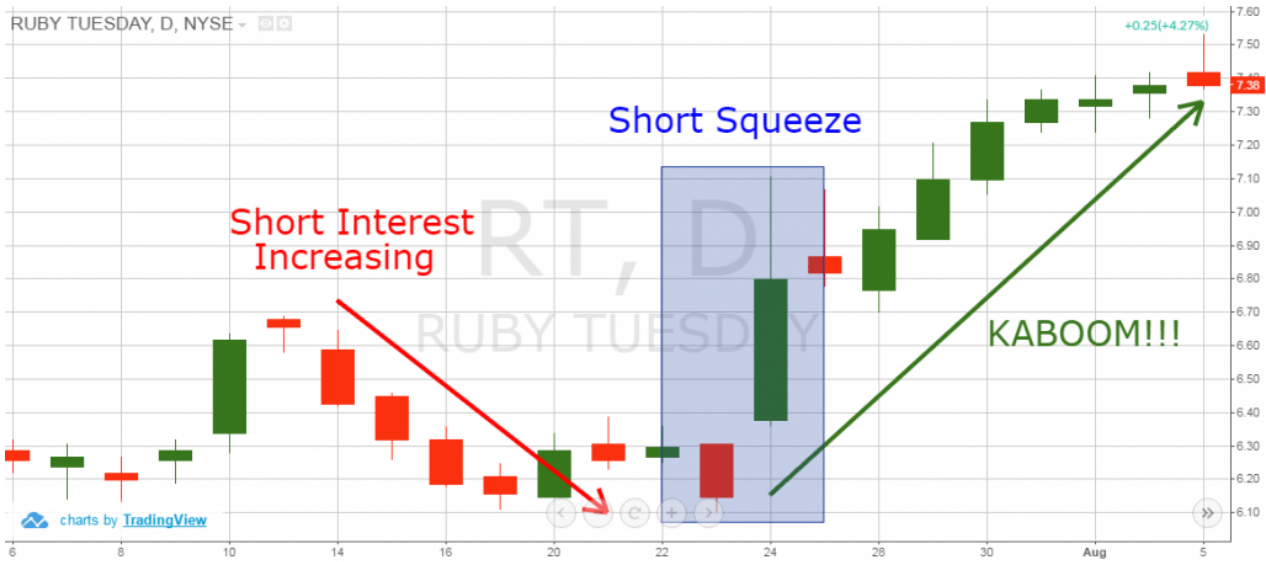
Settlement Date	Short Interest	Avg Daily Share Volume	Days To Cover
7/31/2008	119,388,354	92,434,748	1.291596
7/15/2008	105,884,915	133,641,898	1.000000
6/30/2008	82,804,409	12,448,517	6.651749
6/13/2008	77,348,995	10,683,462	7.240068
5/30/2008	67,824,907	7,362,943	9.211657
5/15/2008	63,174,899	12,306,468	5.133471
4/30/2008	53,188,428	9,179,560	5.794224
4/15/2008	51,192,019	13,277,947	3.855417
3/31/2008	45,525,969	25,105,163	1.813411
3/14/2008	59,343,023	27,328,121	2.171500
2/29/2008	53,497,612	28,785,566	1.858487
2/15/2008	40,092,646	10,350,507	3.873496
1/31/2008	30,367,527	17,314,279	1.753901
1/15/2008	27,997,843	10,810,410	2.589896
12/31/2007	19,027,640	8,847,313	2.150669
12/14/2007	20,658,388	15,362,370	1.344740
11/30/2007	34,805,691	34,084,935	1.021146
11/15/2007	18,594,574	9,826,952	1.892202
10/31/2007	18,118,840	5,688,004	3.185448
10/15/2007	12,799,626	2,866,464	4.465302
9/28/2007	13,648,404	4,043,644	3.375273
9/14/2007	13,630,992	5,865,911	2.323764
8/15/2007	17,459,610	5,504,673	3.171780

Days to Cover Table

Short Squeeze Example

Short squeezes are more likely to occur on small cap stocks than large caps. That doesn't mean that large caps are immune to short squeezes, it is just that large caps need significantly higher pressure to squeeze the float (number of outstanding shares).

Let's walkthrough a short squeeze example where a stock rapidly shifted from a bearish to bullish sentiment.



Short Squeeze

This is the daily chart of Ruby Tuesday for the month of July, 2015. According to Nasdaq, Ruby Tuesday had days to cover value of 13.43 on July 15, 2015.

The short interest for this period was 2,734,418, while the daily volume was relatively low – 201,991 shares. This created the higher days to cover scenario.

We see on the chart that during this period, Ruby Tuesday experienced a five-day decline.

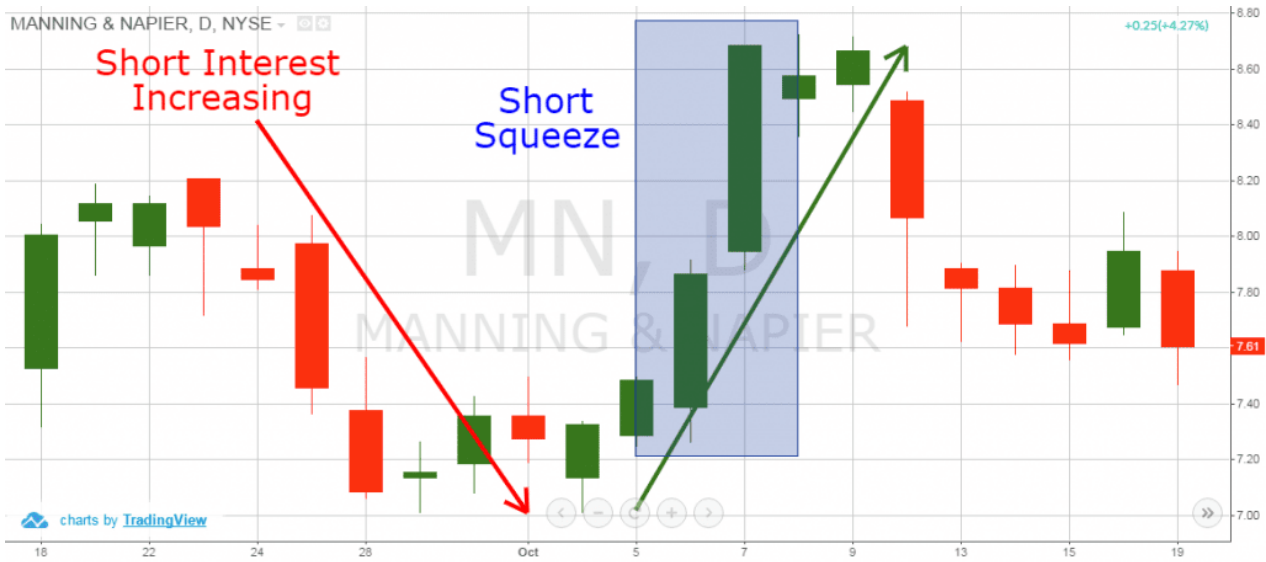
Then out of seemingly nowhere, Ruby Tuesday experienced a strong up day, which sent weak shorts running to the hills.

Notice that the price rally continues for about 8 days and a resulted in a price increase of nearly 20%.

Does this mean Ruby Tuesday is now a great company and will never have trouble again? Nope.

It just means that if you timed the market correctly, you would have been able to capitalize on the number of days it would take to flush out all of the weak shorts.

Let's review another trading example:



Short Squeeze – Ruby Tuesday

Above you see the daily chart of a small cap company called Manning & Napier. The period is Sep 18 through Oct 19, 2015.

The red arrow shows when the short interest of MN is increasing. According to Nasdaq, the days to cover of MN for September 15 and September 30 were 6.00 and 7.45 respectively.

This increase in the days to cover is a clear indication the short interest is increasing over this period of time.

Suddenly, the price decrease stops for few days and then we suddenly see a bullish explosion.

This squeeze causes the Manning & Napier stock price to jump 17.75% in a matter of days.

Finding Stocks Ready to Pop

Short squeezes are difficult to identify by simply looking at a stock chart.

You can always analyze the short interest of a stock and the days to cover; however, you will never be sure when a short squeeze will occur.

For this reason, you can look to technical indicators to

confirm potential short squeezes.

Oversold (Overbought) Indicators

Identifying technical indicators with reliable oversold readings is the most useful tool for identifying short squeezes. Oscillators are a great type of leading indicator as they provide oversold readings right before the positive price action.

Some indicators which provide oversold readings are:

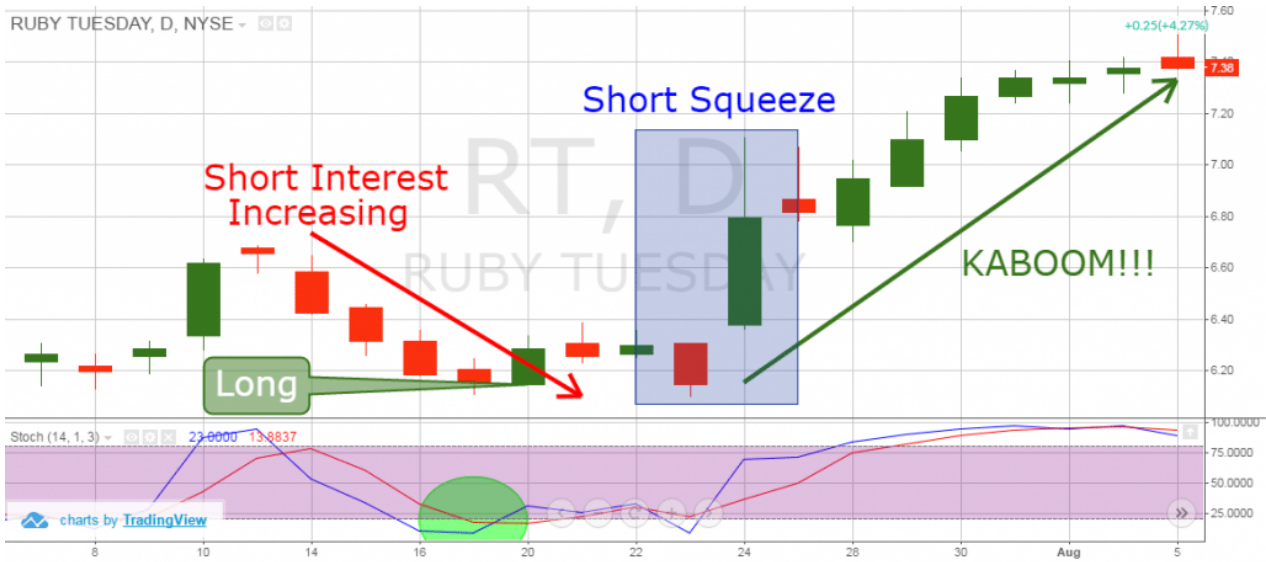
- Stochastic Oscillator
- Relative Strength Index (RSI)
- Commodity Channel Index (CCI)
- Rate of Change (RoC)

Short Squeeze Trading with the Stochastic Oscillator

The stochastic oscillator consists of two lines which are floating in and out of an upper, mid, and lower area.

When the two lines enter the oversold area, we have a potential buy signal. A long trade can be opened when the two stochastic lines cross and exit the oversold area.

Since we are trading a short squeeze, we need to attain oversold signals from the stochastic. Let's see how the stochastic could have been applied in the two cases described above.



Short Squeeze and Stochastics

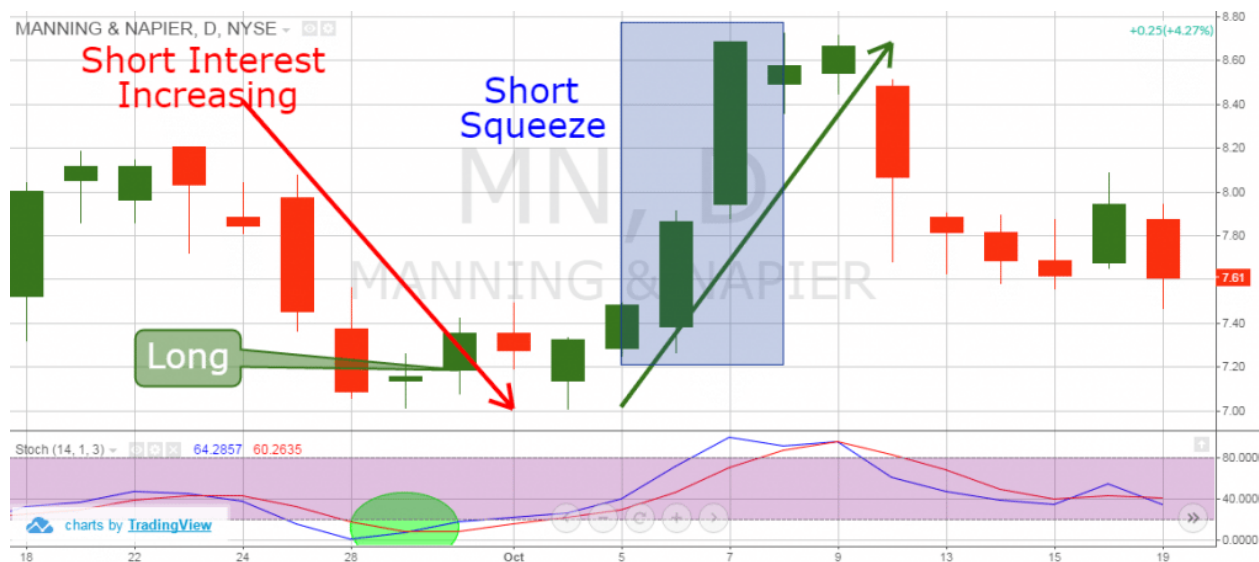
This is the same daily chart of Ruby Tuesday, which we described above. This time, we have added the stochastic oscillator at the bottom of the chart.

Notice that during the period when the short interest was increasing, the stochastic lines cross downwards and exited the overbought area.

After entering an oversold condition, the two lines began to trend upwards.

Three days later, we get a bullish explosion of 16.4% for one day and a further expansion to 20%.

Let's now apply the stochastic to the other example we discussed:



Short Squeeze and Stochastics 2

This is the same daily chart of Manning & Napier, discussed above. Again, we have the stochastic oscillator at the bottom of the chart.

While the short interest was increasing, the stochastic lines were also decreasing.

Then the two lines entered the oversold area. After tracking the price action for a few days, once the lines exited the oversold area, we bought MN.

Two days later a short squeezed ensued. MN experienced a strong bullish move where the price increased 21% in two days.

Short Squeeze Trade Management

Trying to time a short squeeze will be one of the most challenging jobs you find in the market.

The reality is that stocks often have a high short interest because they are crappy companies and the stock price is likely to go lower before making a run.

Think about it, you are in essence trying to catch a falling knife in the hopes of catching the pop.

As I have said many times, in equity trading, you will never be right a 100% of the time. I have also shown you profitable trading strategies with only 20% success rate. Well, it could be said that short squeeze trading has approximately a 10% – 20% success rate. However, if you master your strategy, you might be able to increase this percentage.

Despite the low success rate, short squeeze trading can be profitable as the moves are so violent to the upside and there is no limit on how far the stock can run.

Stop Loss

The one good thing about trading short squeezes is that you can keep tight stops.

When you enter a trade on a potential short squeeze, you should put your stop below the last bottom. So, in most of the cases your stop loss order will be around 0.5% below your entry price.

Target

This is the tricky part.

Your targets on short squeezed stocks will be somewhat extended. Did you notice that in the two examples above we had a 20% price increase for both?

In most of cases a successful short squeeze will lead to a price increase above 15% on small cap stocks.

However, what are we going to use as a signal in order to exit the market?

The stochastic oscillator will do the heavy lifting when determining your exit.

Simply stay in your long trades until the stochastic enters the overbought area. Do not wait for a line crossover in a

bearish direction. Just wait for the lines to enter the upper area and to close one period.

Doing the Math

Let's say you invest \$1,000 in each of your short squeeze trades. At the same time, your system has only a 10% success rate. You risk 0.5% in each of your trades. We will take a minimum target of 10% for our trades.

Below is a breakdown of the math:

- $\$1,000 \times 0.5\% = \5 (loss)
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= $9 \times 5 = \$45$ loss from 9 trades in a row.

- $\$1,000 \times 10\% = \100 (profit)

So, with 10% success rate and a relatively low target of 15%, we are likely to generate:

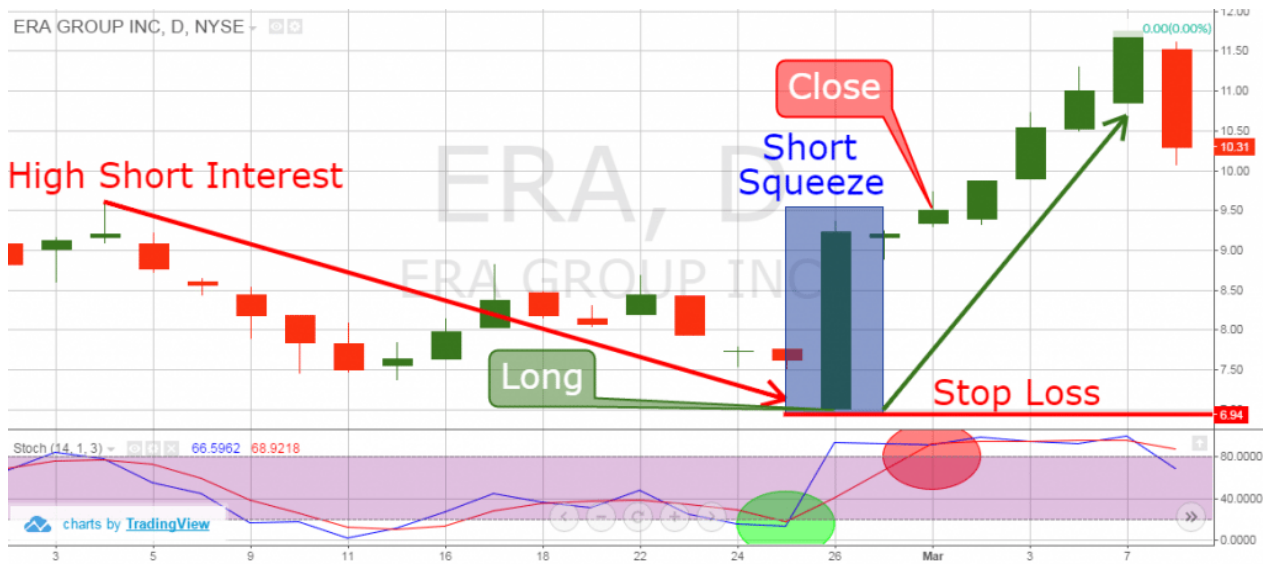
$100 - 45 = \$55$ profit per 10 trades.

Please note you have to be ok losing 9 trades in row. I my friend are not, nor will I have been ok with that low of a winning position.

End to End View of a Short Squeeze

Trading Strategy

Let's now wrap up all rules of the short squeeze trading strategy in one example:



Short Squeeze Trading Example

This is the daily chart of Era Group for February and March, 2016. The image shows a short squeeze scenario.

Era Group is in a selloff leading into the end of February. At the same time, the Nasdaq is reporting 6 days to cover.

The green circle on the chart shows the long signal we receive from the stochastics.

We immediately enter a long trade at \$6.97 per share and we place a stop a bit below this point, since it is the lowest on the chart. Our stop is at \$6.94 per share which is 0.43% below the entry price.

The price starts increasing rapidly right from the moment we entered the market.

The first candle during our long trade is huge. At the same time, the stochastic is increasing as well. Three periods (days) after we entered our trade, both stochastic lines cross

into the overbought area. This is our closing signal and we exit our trade.

We were able to catch a 51% increase on this trade – unbelievable!

So, investing \$1,000 in this trade we would have generated profit equal to \$501, while risking \$4.3. The trade lasted for three days. The risk to return ratio of this trade is huge!

Please remember, these cases are extremely rare!

Conclusion

- The days to cover is a ratio which displays how many days short sellers need to cover their positions.
- Days to cover is calculated by dividing the current short interest / average daily volume.
- Days to cover helps determine if a stock is a likely short squeeze candidate.
- We have a short squeeze when short sellers cover their trades and create extra buying pressure. Short squeezes lead to huge price jumps.
- An oscillator could be helpful when looking for short squeezes.
- When you trade short squeezes you will usually have 10% – 20% success rate.
- When you trade short squeezes, you can aim for increases around 15%.
- You will usually risk about 0.5% of your investment per trade.
- Sometimes, anomalies could occur, where the price increases significantly as illustrated above; however, these cases are extremely rare.