Learn the Best Momentum Trading Strategies for Day and Swing Trading

What is Momentum Trading?

Unlike other traders or analysts who dissect a company’s financial statements or chart patterns, a momentum trader is only concerned with stocks in the news. These stocks will be the high percentage and volume movers of the day.

The only thing you care about as a momentum trader is that the stock is in play.

Now, this is where the nuance comes into play. You have to determine which type of momentum trading best fits your trading style.

In this article, we will dissect the different types of momentum trades, how to enter/exit these positions and what
Chapter 1: Are You Momentum Swing Trading or Momentum Day Trading?

Swing Trading or Day Trading

This question is pretty straightforward, but one we need to address right away.

The patterns and rules are essentially the same; however, the risk and profit expectations are slightly different.

Risks

Believe it or not, swing trading has a greater risk threshold than day trading. This may come as a surprise to some of you, but what’s the one risk factor in swing trading you do not have in day trading?

Overnight Gap

That’s right, if you are a swing trader you are holding a position overnight.
i don’t care how great of a technical trader you consider yourself, there is no remedy for what can happen off hours.

Momentum Swing Trade Failure

Now there are ways around this level of exposure by hedging your trade with an option or futures contract. So, it’s not the end of the world, but you will need to do a bit more homework to reduce your level of risk.

Halt Trading

On the flip side, day trading does not have the risk of overnight moves. The one thing you need to watch out for is if trading halts.

The halting of trading can occur in both swing and day trading but in swing trading your profit targets are much greater, so you can likely weather the storm.
However, if a stock halted goes against you significantly while day trading, it can wipe out an entire week worst a month’s earnings.

Here is an example of a stock Longfin Corporation (LFIN) where trading was halted at 10am on 4/16/2018.

Day Trading Halt

Flash forward to May 9th, 2018 and as of today the stock is still not trading.

Please do not take these examples as me trying to employ some sort of scare tactic, but rather I am trying to give you the worst case scenarios of trading stocks that are in play.

The chances of these events happening are rare, but a possibility nonetheless.
Profit Expectations

When swing trading you are going to go for larger profit targets – point blank.

To this point, if you are holding a position for days or a few weeks, it must make more money for you on a per trade basis than day trading.

Why take all of the inherit risks of an overnight position and your money being tied up for equal profit potential.

Not to mention, if the profit potential were the same between day trading and swing trading, day trading would always win out because you can put on more trades.

Day Traders

For momentum day traders, you could shoot for scalp gains, all the way up to the 7% to 10% range.

Let’s unpack that last statement a little.

If you plan on scalp trading momentum trades, you are willing foregoing the lion shares of the profits. Therefore, you must
have tight stops, because it only takes one bad trade to erase profits for your last 10+ trades.

If you are going for the larger percentage targets, then you must have the mindset you will only hit 20% to 30% of the time. While momentum day trades have the potential for significant moves, they are often fraught with false moves.

Just know the type of profit targets you have for your trading plan and adjust your trading style accordingly.

**Swing Traders**

When I was swing trading I made the most money when I had set profit targets. Funny enough, setting per trade profit targets makes me the most money day trading as well.

As a swing trader you are going to want to set larger profit targets in the 5% to 30% range. Now, if you have mastered the ability to nail the big winners for 100+% this will only make things sweeter. I have yet the ability to master nailing the really big gains without opening myself up to more risks or psychological turmoil.

I am just too greedy I guess.

**Chapter 2: Best Time Frames for Momentum Trading**
Best Time Frames

**Day Trading**

As a day trader, there are only two times of day that matter – the first and last hour of trading. I just completed a study on trading volume on the NYSE which you can review here and this study shows the first and last hour of trading make up over 50% of the entire trading volume for the day.

Well, if you are a momentum trader I would dare to say volume is a requirement for jumping on the momentum train.

The most dangerous time zone for momentum traders is during lunch (12 – 2pm), where volume dries up and the moves are choppy to flat. Many seasoned momentum traders have learned to respect this time zone as a result of loss profits.

**Swing Trading**
Earnings Reports

Swing traders are not absolved from the best time discussion.

You can approach the best time frames for two swings in two ways: (1) earnings season and (2) daily movers.

Earnings season will provide you a constant stream of movers four times a year.

The positive of trading during earnings season is that the entire market is more volatile, which could lead to more gains because you have the entire market behind you if you are in fact right.

Picking daily movers may prove more challenging because you will need to identify a stock that is poised to move not for a few hours like day trading, but for a week or more. This again is challenging when you are trying to identify the needle in the haystack, versus picking trades during earnings season.

Chapter 3: How to Find Momentum Stocks

This is honestly the easiest section of the article to write — kind of.
By definition momentum stocks are securities in play. When you review your market scanner, you should see something like the below image from the Tradingsim platform.

Notice how each security in play is up or down more than 5%.

Now if you are swing trading, you will want to use the same list, but your look back period for chart patterns is longer. You want to make sure you take into account the bigger trends to ensure you are entering a setup that has legs.
Chapter 4: Momentum Trading Strategies

Day Trading

There are two momentum day trading strategies I personally use regularly – pullbacks and breakouts.

To go really deep into these trading strategies, please visit the following articles ‘Simple Strategy for Trading Gap Pullbacks’ and ‘Day Trading Breakouts – 4 Simple Trading Strategies’.

Pullback Strategy [2018 Update]

I like bullet lists because it gives me a clear understanding of what’s required, that I can then turn into a checklist. Well, since it works for me, I hope it also works for you.

- Only open trades during the first and last hour of the day. I prefer the first hour, so I am not sitting in front of the screen for two to three hours a day.
- Trade stocks with solid momentum that are up or down 5%
You need to set a minimum amount of volume traded in the stock. This will ensure you are able to get a good fill on the trade. This also reduces the risk of market makers and other traders running your stop.

Enter the trade after a price retracement in the direction of the primary trend.

Close the position at a set profit target, daily highs/lows or Fibonacci extension level.

Set your stop loss level at the market open, max pain point or after the stock closes beyond a key on-chart indicator such as the 20-day moving average or VWAP.

That was a lot to take in, right?

You will also notice I have listed two or three options for some items. This is because I cannot tell you what risk level works best for you. There are some of you that will want to go with a higher winning percentage and will trade tighter.

There will be others of you that will want to trade more loosely in hopes of making greater gains.

Let’s visualize the pullback strategy to make things easier to digest.
Breakout Strategy [2018 Update]

The breakout strategy is slightly less reliable because daily highs are often a place traders unload their shares. However, you can use the following rules to increase the likelihood of success.

- The first three bullets of the pullback strategy above apply for momentum breakout trades.
- Enter the trade after the stock clears the daily high or low of the day.
- Close the position at a set profit target, prior days’ high/low or Fibonacci extension level. We are calling out the prior days’ high/low as this is another key area for traders to exit their position after the current days’ high/low are breached.

Again, this is a lot to digest. Let’s take it to the charts to...
clarify the action.

Breakout Strategy

The above chart reinforces my point of why I listed two or three options.

In this example, the stock shot way up from a breakout of 9.69 to 10.20. As great of a run this is, FTR did not hit its’ Fibonacci extension level of 10.66.

Here comes the endless question you will face until you just make a call of what works for you. What level do you exit the trade?

There is no wrong answer, just make sure you approach the market consistently on every trade.
Swing Trading

The pullback and breakout trades are the same for swing trades; however, there is a little nuance we need to address. Here is my list of topics you need to be aware of:

- Avoid initiating new trades prior to earnings release. You could be 100% right, but negative news doesn’t care about your charts.
- When day trading, you know things are not going your way if you are sitting in a trade too long. You will need to create a time constraint for yourself when swing trading. Similar to the fact you should not hold day trades overnight, you should not turn a swing trade into a long-term investment.

Chapter 5: Best Momentum Trading Indicator

Day Trading – Level II

The tool of choice for momentum traders is the level II window. The level II window displays the bids and asks for the underlying security.

As momentum traders gain experience, they will develop a keen sense for the movement of the tape. The key to being a successful momentum trader is to know when to exit the position. Since momentum traders initiate positions during the most volatile times during the trading day, sharp corrections are commonplace.

This is why it is imperative that prior to diving into the momentum game, traders must become acclimated to the speed of the market.
I was going to list more indicators, such as the RSI or TRIX, but when it comes to true momentum swing trading and day trading, the best indicator is Level 2. Again, the market is moving so quickly you need to sell at the peaks and not wait for a major market correction before exiting a position.

Swing Trading – RSI

The relative strength index is a great oscillator which helps you identify the overall strength of a security. Since you are looking at a chart on an hourly or daily time frame, you do not want to get wrapped up in every tick on the Level 2 window.
RSI – Momentum Indicator

As a momentum trader, you do not want to get caught up selling the high reading and buying the low reading.

The secret here is to look for two levels – 33.33 and 66.66.

If the stock security stays above 33.33, you are still in an uptrend. Conversely, if the security stays below 66.66, you are still in a downtrend.

Hence, you are looking at the RSI for extreme readings in one direction, that then respect the 33.33 and 66.66.

Leave the buy and sell of the high/low readings to the range traders.
Momentum Trading — Conclusion

While momentum day trading and swing trading is extremely challenging, it can be mastered. One of the greatest momentum traders is Ken Wolff. He has been teaching traders how to successfully use momentum techniques since 1997. Like any other form of trading, discipline is the key to success.

To read more on the RSI indicator, please visit our detailed article here.