

5 Reasons it's a Bad Idea to Hold Day Trades Overnight

Are you a day trader? Have you ever considered holding your day trades overnight? Although many traders and investors conduct this practice, today I will explain to you why it is a bad idea if you are day trading.

Day Trading

What is a day trade?

Day trading is when you open and close your position on the same day. Since day traders have to exit their positions before the market close, they cannot take advantage of long-term market moves. Hence, day traders rely on leverage, liquidity and the ability to place multiple trades per day in order to amass solid annual returns.

Despite the fact day trading happens during the day, there are cases when some traders prefer to hold their positions overnight. I consider this as a very risky initiative as you are taking control out of your hands and allowing external market factors to decide your fate (i.e. news releases, management changes).

But how exactly can overnight trading negatively impact your trading activity?

Well, let's dig into the top 5 things that can go wrong on any given trading day.

Why it's a terrible idea to hold

day trades overnight

1# – Gaps Hurt

If you are a trader, you have probably noticed that when the market opens, volatile stocks will have big opening gaps from the previous days' close.

The reason for this is there are news events that occur prior to the market open that can have a positive or negative impact on the share price. Have a look at the example below:



38.2% Retracement

This is the 5-minute chart of Facebook from Dec 10, 2015.

After the confirmation of a double bottom formation, we decide to go long. Fortunately, the price starts increasing, which is great for our long position. A decrease appears, but we are well aware of the fact the 38.2% Fibonacci retracement held up on the close. Thus you might say: “Hey! It looks like the price will jump back in bullish direction! Let’s hold our position overnight!”

If you do this, you are subject to the risk of an after hours or morning gap. The gap could be bullish or bearish. Therefore, your chances are 50-50 on the trade. Let’s see what happens next in our case:



Gap Chart

“Wow! What did just happen!?” is probably your reaction. That’s right, Facebook gave it up on the open and retraced the previous uptrend in 20% of the time. In reality, this sort of price move happens every day across all of the major exchanges.

If you want to protect yourself from gaps, the simplest way to do this is not to hold your position overnight.

#2 – Your Stop-Loss is worthless

The worst thing when holding your trade overnight is that stop loss orders cannot protect you from the gaps. You will probably say “How is that possible? Isn’t the stop supposed to close my order immediately once triggered?”

That is absolutely correct; however, when there is a gap, the price technically jumps your order, rendering your stop loss worthless.

Once the market opens, the first price will trigger the stop loss, which will likely be well beyond where you hoped to cut ties.



Stop Loss Orders

If you placed a stop loss at the 38.2% Fibonacci level around \$105.14, Facebook jumped this stop on the open and would have executed at \$104.14.

While you thought you limited your risk to a maximum price decrease of \$0.28 (28 cents) per share, based on an entry at \$105.42; in reality, the decrease you would have experienced equaled to \$1.26 per share.

Another way of saying this is that you now loss 4.5 times would you had first set out in your trading plan.

If you are the type of trader that uses more cash with tighter your stops, this sort of hit could prove as a serious setback for your weekly or monthly profit targets.

If you sometimes consider keeping your trade overnight just remember the following: stop loss orders cannot protect you from gaps in the opposite direction! Therefore, you have three alternatives:

- Not to hold day trades overnight.
- Hold your position overnight and take the 50-50 risk of a gap.
- Hedge your position with another financial instrument.

It is your call which of these you are going to chose. My

advice is, go with the first alternative, if you do not feel 110% comfortable with the other two.

#3 – Broker's Punishment

Yes, that is correct. Brokers can and will charge an overnight fee on some day trading accounts. This fee can run as high as a few hundred basis points.

The less fees you pay the greater odds of success. So, if you are that much in love with the stock, you can always reopen your position in the morning.

#4 – Bankroll Size

If you would like to hold a trade overnight you should definitely have a solid bankroll. Since you plan to stay in the market with the looming risk of a gap, you should make sure you can afford any potential margin calls.

A margin call means your broker will start selling your assets in order to cover any shortfall. In other words, your overnight trades and available cash could be wiped out to cover the broker's potential losses.

The other way to protect yourself from the aggressive margin call is pretty straight forward –deposit more money! However, cash sitting in an account just to protect against a potential margin call does not provide the best rate of return.

#5 – Stress

What about you? If you somehow manage to tackle the insidious market and get out unscathed, you should ask yourself this question: "Is holding a position overnight worth the stress?"

The first four reasons not to hold a position overnight all translate into stress on you.

Think about how you are going to spend the night in your bed when you have all of this on your mind.

Isn't your bed the place where you should relax, gaining energy and strength for the next trading day?

Conclusion

- Day trading is the process of trading financial instruments within the trading day.
- Day trading is a full-time job, which requires discipline, consistency and self-confidence.
- Day traders sometimes hold their positions overnight, which exposes them to external variables.
- The reasons not to hold day trades overnight include:
- You put yourself into a great risk of market opening gap.
- Your stop loss order cannot protect you from that gap.
- Your broker will charge you an extra fee for leaving an open trade overnight.
- You can get an instant margin call with the opening of the market.
- You might not be as experienced as you think in order to tackle the market in the morning.
- You will expose yourself to a great stress.
- Holding your stock overnight is considered a very risky activity, which should be implemented only from the most experienced equity traders.