THE 10 COMMANDMENTS OF TRADING PENNY STOCKS

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The 10 Commandments of Trading Penny Stocks

By Chris Johnson

1. Set entry and exit rules.

Discipline is paramount when it comes to trading penny stocks. These names move a lot faster than your typical New York Stock Exchange ones.

On large-cap stocks like Nvidia, Apple, and Alibaba – there's a lot of news every week. There are things you can see coming down the road, be they announcements, earnings reports, or analyst calls.

With more information, there are slower moves. Nvidia isn't going to move 70% in a single day. It has the law of big numbers working against it.

And slower moves = Less emotion for traders.

On the flip side, when you take virtually unknown penny stocks, there's a lot less info. You won't see an earnings report or an analyst call blasted on CNBC headlines about one of these OTC names.

And with less information, there are faster moves. Penny stocks have the law of *small numbers* working against them. And with that comes *more* emotion.

Emotions and investing are inseparable, especially when you're trading penny stocks and watching your money rise and fall at a

much faster pace. If you want to maximize your profit potential, then you have to train yourself to manage them together. The heat of the moment can lead to mistakes if you don't have a predetermined plan.

That's why it's incredibly important to set entry and exit prices *before* a trade is opened. And stick to them.

How? Well, to start, we'll use **stop-limit** orders to enter Penny Hawk trades. That means we won't buy a stock until it reaches a specified price – and we'll never pay too much.

We'll set tight **trailing stops** as a way to minimize losses and guarantee gains.

And we'll do it all to ensure we keep emotion out of it – and money *in* it.

Think about it. Your investment is climbing up higher and higher. You told yourself you'd get out at 100%, but you want more – and you abandon your exit strategy right before the stock tanks, putting you right back where you started.

That's exactly what we're trying to avoid.

500%, 700%, 1,000% – they're all attainable profits with penny stocks. But you can't go into a trade trying to make 1,000%. That's like putting $500 down on green in a game of roulette – and we aren't risking our money like that.

We're targeting specific, consistent gains. And we're doing it with specific entry and exit rules.

2. Never trade alone.

When it comes to trading the regular stock market, you should always avoid bandwagon stocks – you know, those names that

everyone jumps on just because they have FOMO. Take GameStop, AMC, and Dogecoin – by the time they hit the mainstream media, it's usually time to *exit*, not enter.

But the game is a little bit different in the penny stock market.

There are less people trading penny stocks than trading, say, Apple. So when trading the OTC, you need the market to do the heavy lifting for you. You're not going to move a stock by yourself.

That's why I monitor trends in volume. When the crowd *starts* to lift a stock, that's when it's time to jump in.

I look at a stock's average 10-day volume to search for names about to pop. When that 10-day average starts to pick up, that tells me something is coming. Check out this chart of **Fordwardly Inc.** (OTCMKTS:FORW), a $0.22 stock that took off in early 2021…

Those vertical bars on the bottom represent volume. As you can see, volume was relatively flat from September to November. Then,

it slowly started to pick up, peaking at the start of December and February – directly correlating to a massive jump in the stock.

When volume starts to pick up, *that's* when we get in. But make sure you're not the last to leave the party – you don't want to be the one left cleaning up the mess at lower prices. You can tell just how quickly FORW dropped back down the moment volume started to dip.

3. Volatility is your best friend.

To make money on low-dollar stocks, you need them to *move*. That means you need volatility.

And penny stocks are some of the most volatile names out there. But it doesn't help to get in on a stock *while* it's jumping around.

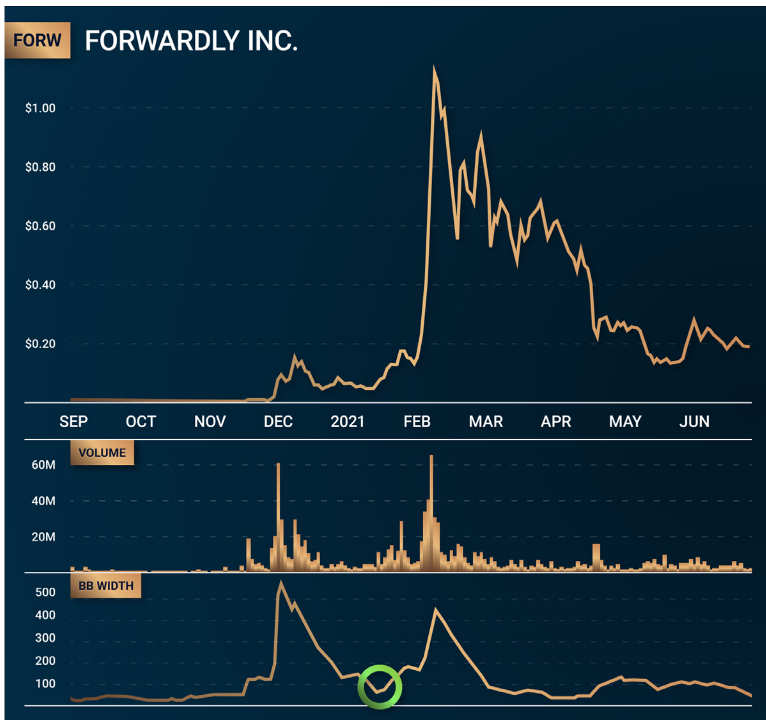
You want to watch for the "calm before the storm" – and take advantage of it. Rising volume levels tend to indicate volatile waves ahead. And those waves drive prices higher – *fast*.

How do you find the calm before the storm? With something called *Bollinger Band Width*, which you can see on the bottom of this FORW chart (next page).

I like to call this the *volatility band*. See those spikes? That's volatility. When the band is moving up, volatility is high. If, however, the band is low, that's when I'm paying attention.

If the volatility band is low, but volume is rising – *that's* the calm before the storm. Rising volume + Low volatility = The time to get in.

Listen to what stocks are telling you. That's how you take advantage of volatility. To ride the trend to profits, you need to be there *ahead* of the waves of investing.



4. Round numbers always matter.

Just like their higher-priced counterparts, micro-cap and penny stocks trade with heavy support and resistance at round numbers. Why? It's all psychological. Traders always target buying and selling opportunities using round numbers because they're easier to measure in our minds.

Most people say, "*I'll buy XYZ stock when it gets to $2. I'll sell it at $4.*" They don't say, "*I'll cash in at $2.13 and cash out at $5.34.*"

So usually, when a stock hits a round number, it's a sort of milestone – and you'll see a lot of movement either in or out, marking support or resistance.

But things are a little bit different with penny stocks. They don't hit $5, $10, or $20. The lower the price, the smaller the increments – meaning when you're dealing with penny stocks, we're looking at increments of nickels.

When a stock is bouncing between $0 and $0.30, "round numbers" are $0.05, $0.10, and $0.15. All you have to do is move the decimal point.

5. Technicals matter.

The 50-day moving average, the 20-day moving average, and the relative strength index – these aren't just fancy terms I toss around for no reason. Just like volume and volatility, these are important indicators when we're looking at penny stocks.

Before we buy a stock, we want to make sure that it's heading *up*. And that means the 50-day and the 20-day moving averages have to be trending up as well – if not, you'd be heading into dangerous territory.

See? The moment the 50-day and the 20-day – marked by the green and red lines, respectively – start trending down, the stock follows suit.

If volume is rising and volatility is dropping – our indicator to get in during the calm before the storm – *but* the 50-day is dropping, then that's it. We're out.

6. Overbought can always become more overbought.

This commandment works in favor of penny stock traders almost every time. Low-dollar names have a natural tendency to "run" as the crowd becomes aware of a breakout, triggering a buying frenzy that almost immediately results in parabolic moves higher.

And when a penny stock is on a run, it moves in much larger magnitudes than a larger-cap name. Think about it – a $0.50 stock can get to $5 much more easily than a $50 stock can make the same 900% jump to $500.

For this reason, low-dollar and penny stocks have a natural tendency to shoot into technically overbought territory, which would typically have traders closing positions immediately – tanking the stock.

Per Commandment #1, follow your pre-trade plan – so you don't get stuck waiting for a stock to get higher only to see it get pummeled.

7. Fundamentally sound is better than fundamentally proven.

When I'm trading the regular stock market, I remind myself that stocks are driven higher by speculation, not fundamentals. And that lends itself well to penny stocks too.

See, I call the OTC market the "public IPO exchange." There are so many opportunities to get into companies on the ground level as they bring both exciting and often, new businesses to the public.

Unlike the IPO market, where early investments are limited to those "in-the-know" investors, the OTC market is open to anyone looking for insider-style opportunities.

But these companies are typically in the early stages – meaning there aren't many fundamentals to be proven. Instead, you're investing in an *idea*. And oftentimes, fundamentally sound ideas turn to gold.

Here's an example – **Amazon**. Before the e-commerce giant was the booming success it is today, it was just a company with an idea. Selling books online – the idea was sound, but it wasn't proven yet.

Early investors in Amazon were investing in an idea. There weren't positive earnings or profitable numbers to count on. And that's what it's like when you're buying penny stocks too.

Take **MindMed Inc.** (Nasdaq:MNMD). Before it was listed on the Nasdaq, this was just a penny OTC stock. It's still not profitable, it's not FDA approved, and it's not *fundamentally proven*. But in the past year, its shares have grown 1,158%.

Forget what you know about fundamentals. These companies haven't proven themselves yet – but that's exactly what makes them so profitable for traders like us.

8. Short sellers are the enemy.

Usually, short-sellers are a trader's *friend*. They can end up squeezing stocks infinitely higher – like in the case of GameStop

and AMC – via a short squeeze. But they can do real damage to stocks that are lightly traded over the long run.

Remember – less info on a stock means more emotion goes into trades. And with less info available on the company, a short seller can end up sinking a stock 50% just by betting that it will.

So watch the shorts. If they start coming in, then our guard goes up. Our trades are tightened. And we protect our cash.

9. Listen to the noise.

This feels counterintuitive, I know. Usually, traders tell you to block out the noise and focus on the trade at play. But I'm telling you to always look for the "noise in the trend."

Oftentimes, "noise" is simply a sudden increase in volume – and that signals a new buying trend is emerging in a stock. These trends lead to the buying frenzies that result in huge profit potential. Listen to that noise. It will identify large parabolic rallies.

And penny stocks are *noisier* – meaning the profit potential is greater. The volatility on FORW is much more than that of large-cap stock Apple Inc. or Amazon.

When it's quiet and you notice the stock getting jumpy – making erratic moves... listen to that noise. It'll lead you straight to the cash.

10. Never overstay your welcome.

Remember what I said – things move quickly in low-dollar markets. It's one of the reasons that these stocks are so profitable – but it's also a reason to be careful.

Pigs get slaughtered. When you're trading low-dollar stocks, you can't be greedy. You have to stay alert, nimble, and reactive. But that's exactly what I'm here for. I'll do the analysis; you do the trade.

And the moment it's time to leave a penny stock – and pocket the cash – you'll know.

To your success,

Chris Johnson

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