Dan Zanger: Coast-to-coast trading

He ran up some big numbers in the bull market, and Dan Zanger is still practicing his high-flying brand of momentum-stock trading. But he thinks this year's market might be a tougher environment than many people expect.

BY *ACTIVE TRADER* STAFF

Many people dream of striking it rich in the markets and retiring to a warm, sunny part of the world, maybe whiling away the days on a boat and enjoying the good life.

Dan Zanger's doing that, except for the retirement part.

"Dan Zanger's sink-or-swim trading" (*Active Trader*, August 2004) profiled the former swimming-pool builder's trading career and his spectacular returns during the height of the 90s bull market — 29,000 percent in a year and 164,000 percent over 18 months. He amassed $42 million before losing more than half of it when the market bubble burst in 2000, but he was still a millionaire when all was said and done.

Except he wasn't done with the markets. He continues to trade, runs a Web site (www.chartpatterns.com), and has launched a hedge fund. But one thing has changed. A native of southern California, Zanger moved to southern Florida — trendy South Beach, in fact — a few years ago. Besides his obvious affinity for sunshine and beach, Zanger points to a more pragmatic aspect of relocating — the Sunshine State's tax status.

Tennis, golf, the beach, boats, the nightlife…and no state income tax.

"It's an excellent combination," he notes.

Zanger still trades his personal account, which he says gained 180.6 percent in 2005 (substantiated by documents submitted to *Active Trader*). Although he's switched coasts, he hasn't changed his personal trading style, which still consists of making big bets on big-name momentum stocks. We caught up with him in early March and asked about his trading and his feelings about the current market — and how it's treating his preferred trading style.

AT: *What were you trading last year?*

DZ: Just the big movers in the market. I owned a lot of Google, Apple, and early in the year I owned a lot of housing stocks.

AT: *What made you choose what you selected?*

DZ: Basically, they had strong fundamentals — specifically, strong momentum-style earnings, which is different than just good earnings. It means earnings are continuing to increase every quarter, not only over the year-ago quarter, but also over the prior quarter.

Let's say eight quarters ago earnings were up 20 percent. Then the next quarter they are up 25 percent, then the next quarter they might be up 35 percent, then up 50 percent. They just continue to increase — up to 70, 90, maybe 140 percent.

This is what the home builders and Google were doing. Certainly, this is what Apple was doing — it had spectacular revenue and earnings growth. All these stocks fit into a momentum-style fundamental model.

AT: *Had Google been around long enough for it to have a track record you felt you could trust?*

DZ: Yes. The IPO was in August 2004 and their earnings expanded rapidly for the first four to five quarters. But the earnings started to decelerate three

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quarters ago (*mid 2005*). Earnings were up 143 percent in March 2005 — their high point — and revenues were up 93 percent.

AT: *So were you out of the stock by the time the most recent earnings came out (when Google tumbled on poor numbers)?*
DZ: I was actually short the stock when it collapsed on the earnings news back in the first week of February (*Figure 1*). I shorted the stock at $432, five minutes before the close of trading — right before the earnings were announced.

They missed their number by around 20 cents and after-hours trading was halted in the stock just before the announcement. The stock opened 20 minutes later and started trading briefly around the $355 area; I quickly put in an order to lock in profits. The stock began moving up rapidly from its low point and my average fill was around $364. The stock rocketed up to close the after hours session at the $385 area. It opened the next day around $390.

AT: *Had you been planning that for a while?*

FIGURE 1 CATCHING THE BREAK

Having watched the company's earnings decelerate, Zanger fortuitously timed a short trade in Google just before the company announced poor earnings at the beginning of February. He had previously exited a long position in the high-flying stock in January around $460.

Source: TradeStation

Even though pundits are saying interest rates are relatively reasonable, I don't really buy into that. The market tends to get into trouble when rates get over the five-percent mark.

DZ: Yes. I'd been out of the stock for a while, and I'd been waiting for this. I saw the volatile whipsaw moves the stock was making — in January it went from around $470 to $390 really quickly — and I sold my long position somewhere around $450 when the stock broke a high-level mini-flag pattern.

AT: *You said you saw Google's earnings decelerate. Is there a certain drop-off you look for to suggest earnings have topped and price might subsequently top?*
DZ: In select, big-moving stocks that grab the public's attention, earnings can begin to decelerate before price does. There are other situations in which the stock will sell off in anticipation of declining earnings. You see both, and you have to be able to understand both situations. Typically it's better if the earnings decelerate before the stock breaks down and the Street is still infatuated with the stock. That was the case with Google.

It was also the case in 2004 with eBay. The earnings decelerated in the third quarter of 2003 and the stock eventually collapsed on an earnings shortfall and lowered guidance from eBay in the third week of January 2005. I was short 160,000 shares of eBay when it missed its numbers and gapped down $20. At the time, that was my biggest one-day gain in a single stock.

AT: *If Google's earnings had started to decelerate three quarters before, why hadn't you shorted the stock one or two quarters earlier, for example? What finally made you take the leap of putting on a short trade?*
DZ: I try to never short a stock until earnings are coming out and pattern and

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volume activities are starting to act bearish. Big breaks for short selling usually come on poor earnings or preannouncements.

Google was acting weak throughout the summer of 2005, but the stock wouldn't go down. It eventually built a big, but not easily identifiable, base that lasted about five to six months. This told me the stock had super potential to move up on earnings that were due to be posted in October.

The October to December period is one of the strongest times in the market every year and this stock still had earnings to move it.

AT: *So do you tend to make the majority of your gains from a relative handful of trades, or is it more spread out?*

DZ: I test the waters on a lot of stocks that break out, and I probably sell at least 50 percent of them either a minor gain or loss because they aren't acting the way I want them to.

It's just like fishing — you never know when you'll get a big fish on the line. One thing is certain — if you don't step in and buy the stock on the breakout, you won't have a chance to know what you've got. So I do a lot of fishing.

AT: *How frequently do you trade these days?*

DZ: The market this year has been so bad that I'm not trading too much. Interest rates are high and moving higher and earnings on most stocks are beginning to decelerate quite rapidly.

AT: *But you're not afraid of selling short. Are there opportunities to go that way?*

DZ: The whipsaws that are occurring right now are similar to what occurred when the bubble burst [in 2000]. Stocks would go down, set up for short trades, start to go a little lower, and then the market would get oversold or a news story would come out, and suddenly, they all turn higher and rally significantly — to the point you'd have to cover your short at a loss.

Things are similar now to the market in 2000 and 2001, except on a much smaller scale.

AT: *How often, approximately, do you go short relative to going long? Do you prefer the long side to a significant degree?*

DZ: I've never kept count, but I would guess I prefer going long rather than short 98 percent of the time. Remember, a stock can only go lower by 100 percent, but it can go higher by 200 to 3000 percent or more in a year or two.

AT: *Are you trading stocks exclusively, or do you trade futures or options?*

DZ: Ninety-five percent stocks. I prefer the Nasdaq, but I really don't care which exchange. The market makers on the NYSE…they're a tough crowd, and as a result NYSE stocks act completely different than Nasdaq stocks.

I think a lot of institutions prefer to play the NYSE stocks, and they do a lot of dip buying. Certainly banks and insurance companies are buying for the longer-term; they don't care if a stock has broken a pattern, they just see it as a buying opportunity.

I think the Nasdaq market is more technically oriented.

AT: *You mentioned the kinds of things that align to get you in a trade. What about getting out? Do you leg out of positions — take partial profits?*

DZ: Typically, I'll hold a successful, moving stock from a couple of weeks to a couple of months. When the stock is moving strongly in one direction, either up or down, volume at some point will begin to dry up. When this starts to happen, I consider when I will begin to sell a portion of my holdings. It might be that day, or within a week or two — but it will happen soon.

And, yes, I try to sell on the way up. When a stock becomes very extended from its original breakout point over many weeks, I want to reduce my positions dramatically. I also get out of a trade if the stock breaks out and then goes nowhere. Why own a stock that just goes nowhere?

AT: *How many of your general principles or trading rules have you quantified?*

DZ: I don't really do that. You know, people frequently ask me what the target price is for a particular stock. Where do I sell?

My response is that I never have a target. The Street doesn't give you a predefined target, and if I determine I want to sell at $130 and the stock goes to $180, I just missed $50. So I let the action of stock and the duration of the position tell me when to sell it.

AT: *So if you're selling a long position while the stock is moving up, are you doing it by using some kind of trailing stop? There's also the risk of giving back open profits if you wait too long.*

DZ: I kind of use price action rather than a predetermined, trailing stop in dollar terms because a stock could, for example, make a light-volume pullback in a strong bull market. Your stop might get hit but the stock could turn around at the end of the day, close up, and move to new highs over the next few days.

AT: *Does this mean you'd consider a correction with higher-than-average volume a reason to exit a trade?*

DZ: Yes. If it was a pullback on higher-than-average volume, that goes back to what I refer to as the action of the stock telling me when to get out. If I see a high-volume sell-off — even though it might turn out to be temporary — I'll sell 50 percent of my position just to pro-

If the market wasn't a new learning experience every day, I think I might be bored with it.

tect against further downside risk. But if the stock turns around and has a high-volume up day that recoups that down move, I'll buy that 50 percent right back.

AT: *Do you approach the market from a longer-term perspective, or do you just approach things day to day?*

DZ: Very much day to day — every day is a new day. In momentum trading, if you don't see every day as a new day, you're not going to be a momentum trader very long.

AT: *Do you have to force yourself not to develop a longer-term, overarching perspective of the market that might clutter what you do from day to day?*

DZ: I'm not a long-term forecaster, so I try not to get into that. Having said that, I've been pretty good over the past couple of years predicting which stocks would make big runs during the year. And right now, I don't see a single stock in 2006 that's going to be as significant a mover as Google or Apple was last year. I think it's going to be a flatter, choppy year, which can be dangerous for momentum traders who trade size.

I've seen [these types of markets] before, and they're usually marked by high interest rates — especially as you exceed the five-percent range. The market tends to get into serious trouble when you get over the five-percent mark. Even though pundits are saying interest rates are relatively reasonable, I don't particularly buy into that. I've seen many markets over the past 15 years get into trouble when interest rates move up to this level.

AT: *Have you ever tried to teach anyone your trading method?*

DZ: I have, but I haven't found anyone who can do what I do. I don't think I'm a bad teacher, but you know, this takes an awfully long time to learn. I put in 40- to 50-hour weeks for six to seven years before I got to the point where I was making consistent money in the market.

AT: *Is first-hand experience risking money the only way to do it?*

DZ: It really is. You need to have the basics of trading and a broad outline of all the different rules you'll follow. Let's say a stock forms a very bearish outside reversal day on very high volume after the stock has moved up for a long period of time. You just sell the stock without hesitation when that happens. You don't worry about it — you just walk away, take your profit and you don't look back. Similarly, if a stock starts getting choppy, you walk away.

These kinds of rules — there could be hundreds of them — you learn over time, and you have to get them so ingrained in your brain that you can refrain from breaking them and making stupid decisions.

AT: *That's a difficult thing.*

DZ: It is difficult. And I can't say that I've mastered it myself, even. Today, the oil stocks broke down once again and I spent the day after I sold them at a loss, kicking myself because I had told myself not to go back into these stocks, even though they were breaking out of decent bases.

But they weren't coming out of their bases in an aggressive manner, which told me at the time [I bought them], these stocks were not under heavy accumulation and were subject to a breakdown — which they did a few days after I bought them. As soon as I noted the lack of aggressive buying in these stocks, I should've sold them immediately on the same day without question or hesitation.

One of my rules is to only own stocks that are bid up aggressively, as that's a strong sign a stock is going much higher and is far less subject to failure. I broke one of my own rules here and paid the price in seven digits. It hurt.

Stocks just aren't working well right now. I can make a list of things that tell me, "Don't trade this market." For instance, interest rates are approaching five percent, and there's really no true leadership in this market.

I've seen this kind of market a number of times over the past 15 to 18 years and the key to surviving is not getting hurt in a choppy market or sucked in on false breakouts or rallies.

AT: *Do you think you've progressed, psychologically, as far as being able to recognize and handle this kind of thing?*

DZ: Yes. I'm more capable now of identifying bear-market behavior and staying clear of it. Bull markets last for long periods of time — anywhere from a year to two-and-a-half years — while bear markets typically last eight or nine months, maybe a year. So you always wind up being in more bull markets than bear markets. Bull markets are easier to make money in, and they're more exciting.

It's harder to define the bear. And once you're in it, you start getting chopped up and losing cash. And typically it's the drawdown in your portfolio that tells you not to trade. Getting to the point where you can say, "This is a bad market; stay out of it" and avoid taking the drawdown — takes a long time. I think I've almost gotten to that point. I think I'm there in certain areas, but I have some things to tweak in others.

But you know, if the market wasn't a new learning experience every day, I think I might be bored with it. I don't need to work any more — it's the challenge that keeps me going.