<u>EXIT TACTICS FOR LOW LIQUIDITY TRADES</u>

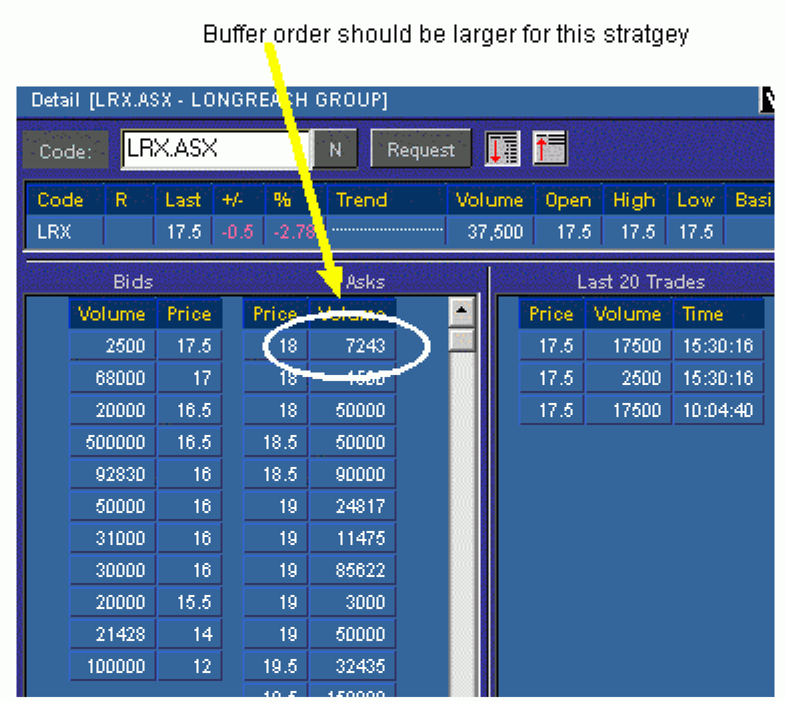
By Daryl Guppy

Low volumes, or low liquidity, makes exiting a trade difficult. This does not cover the situation where the market eats all your profits and starts consuming your capital.

This feed-the-market approach allows a trader to unwind, or sell, a large position piece by piece by meeting the market makers bid buy price.

To show how this works we set up a sample trade with LRX. The objective is to exit at $0.18 in a thin or low volume market. It is a softly, softly approach and the screen shot from the course of trade screen shows how it operates.

We have 118,000 shares in this open position for an initial purchase price of $20,000. Once the stop loss point is triggered the plan calls for us to sell the shares. If we place a sell order for the full amount then we ‘bully the market.’ This simply means our order is so large in comparison to other traders that it dominates, or swamps the order line. If we are big buyers, this tends to push the price up. Potential sellers see the large buy order so they lift their own asking price knowing that the big buyer will probably chase prices to fill his order. The reverse applies when selling.

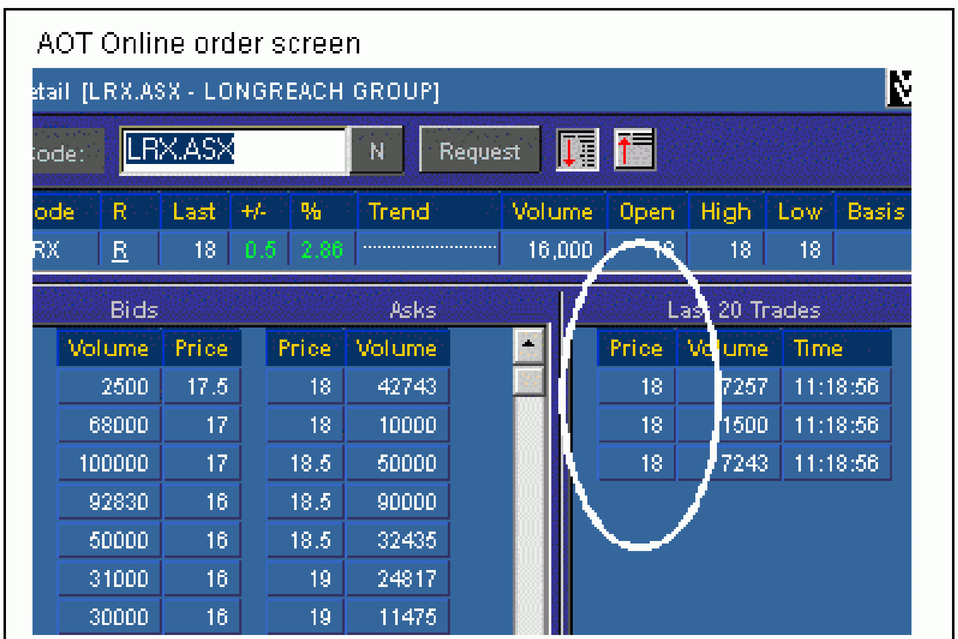


AOT Online order screen

If we put in a large sell order then potential buyers hold back waiting for the price to drop. This is particularly so in a weak market where buyers are not active. The sellers solution is the same as that used by the large institutions. Like them we break up the sell order into smaller pieces. The institutions do this by placing sell orders with several different brokers. They reward those who can get the best average price.

We cannot do this, but we can control the number of our shares that appear for sale in the order screens. There are three ways to achieve this.

- First, simply place all our 118,000 shares for sale at $0.175. Like a big bait, there will be some small traders who will nibble away at this. It may take many days to completely sell the order. It also runs the risk of dominating the market as discussed above. This is the least effective solution.
- Second by placing a sell order at $0.175 for perhaps 10,000 shares. Once this order is filled, a new sell order is placed at $0.175. This continues until all our shares are sold. This approach means we must watch the screen all day, and replace our sell order every time it is filled. This solution is not bad, particularly if you have a pager alert system that tells you when each small order has been sold.
- Third, the exit is achieved by selling at market whenever there is a bid at $0.175. This is a more complex and time consuming strategy. It is the one we use to exit this notional case study trade. It is the most effective strategy because it attracts other traders. You must sit on the screen all day and manage each sale. The strategy works like this:



The buffer order is hit as well

We offer 20,000 or 40,000 shares for sale at $0.18. If we get sold at this price this is very good, however the objective is to set a buffer in the market. Often the next buy order will be $0.05 below this – at $0.175. They bid up to the buffer price. This is our planned exit price, but the buyers are trying to entice the seller at $0.18 to drop his price. .

If we set a sell order at $0.175 then the next buy order is most likely to appear at $0.17. We lift the bar by keeping a sell order in place at $0.18, just above our planned exit price. This is like a bait.

Whenever a buy order appears at $0.175 we hit it with an exact at-market matching order. Using the screen extract above, this means we make the first sale of 17,500, followed by 2,500 and then again by 17,500. If we meet the buy order for 2500 we succeed in selling 42,500 shares on this day. When we meet the market at $0.175 we also 'mark the tape' with our selling activity. Other traders see sales at $0.175. This activity has two important effects.

- First it reassures those who already hold the shares. They see interest and trading in a stock that had slowed. This usually renews their hope and they hold off selling. This reduces the selling pressure.
- Second this increase in activity attracts the interest of other traders. Those who have been watching this share may take the trading activity at $0.175 as an indication in increasing momentum. Sometimes they are eager enough to take out your reserve buffer order at $0.18 because they believe the buying activity at $0.175 is an indication of a rebound.

This is exactly what has happened with LRX as shown by the later order screen extract. For the purposes of this example trade we show an exit for half the shares at $0.175 ($10,325) and the other half at $0.18 ($10,620) as the benchmark order is sold. Our objective is to 'unwind' our position in a low volume environment. This calls for careful management of the way we sell the stock. There are a variety of strategies and their success depends on the time we have available, and our understanding of the way other traders interpret the price action.