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: 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

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: It’s better if earnings decelerate before the stock breaks down and the Street is still infatuated with that stock. That’s what happened with Google.
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?

**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 preannouncement.

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 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 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 cou-
ple 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 mar-
ket 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 any-
one 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 trader, 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
weren’t 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 accumula-
tion 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 identi-
fying bear-market behavior and staying
clear of it. Bull markets last for long peri-
ods of time — anywhere from a year to
two-and-a-half years — while bear mar-
kets 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 typi-
cally 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 chal-
lenge that keeps me going.