

Question:

Would you explain a Stop and Stop Limit order for me? They can be very confusing.

Answer:

Many investors find order types, and especially Stop and Stop Limit orders, difficult to understand. I'll start with the definitions and then provide some specific examples to help clarify for you.

Stop Order

A Stop order is an order to buy or sell a security when its price surpasses a particular point, limiting your loss or locking your profit. Once the market price surpasses the predefined entry/exit point, the Stop order becomes a market order, and is then handled as defined under the definition of a market order. This type of order is also referred to as a "Stop-Loss order."

These types of orders may be placed with special instructions, like AON (all or none) and GTC (good until cancelled). Stops are not a definite guarantee of getting the desired entry/exit points. For instance, if a stock gaps down then your Stop order will be triggered (or filled) at a price significantly lower than expected.

- Buy Stop Orders – The Stop price is set above the current ASK price
- Sell Stop Orders – The Stop price is set below the current BID price
- Depending on market conditions, once the order is triggered, there is no guarantee of the execution price, and the price received may be several points away from the Stop price.

As an example, we want to sell our position if the price of the stock drops to 30.25. Wait a minute! Lower than the prevailing market bid of 33.56? Yes! Because we won't actually *trigger* the Stop order until GE trades lower to 30.25. Until that time we still own 10 shares of GE. A Stop order is a protective order that limits our loss from the purchase price. Let's investigate.

After entering the symbol and the number of shares, select "**Stop**" from the Order Type drop-down box. As soon as you select Stop, the Stop price field will become accessible. It is important to note that for a sell order, the Stop price must be *lower* than the prevailing quote, which in this case a bid 33.82, so our Limit order of 30.25 *is* lower.

Let me briefly diverge and explain a Buy Stop. If we had decided to *add* to our GE position then we could use a Buy Stop which would require the price placed in the stop price field to be *higher* than the prevailing market in this case an offer of 33.78. In this example, we only want to buy GE if the price rises to \$36.75 (*see illustration 1*).

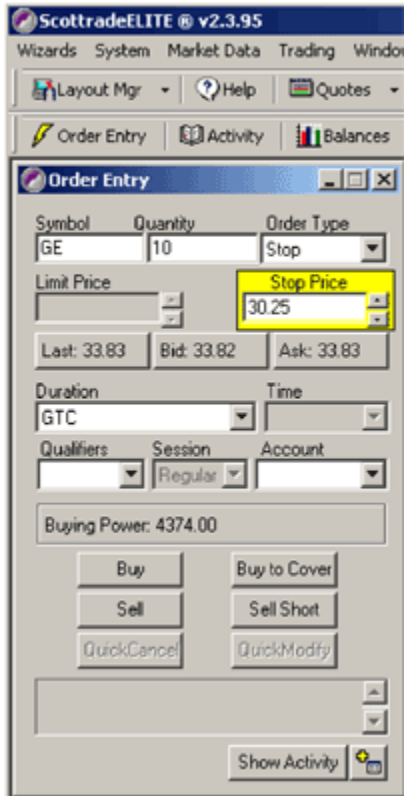


Illustration 1

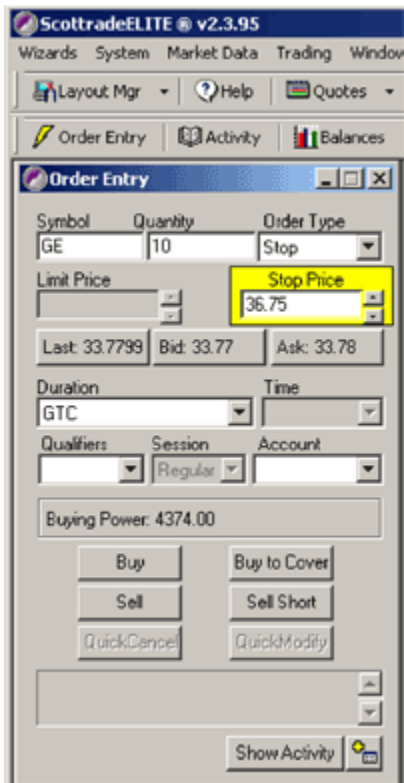


Illustration 2

One last reminder, whenever any Stop price is triggered, that order becomes a *market order*. So, in our example above, if GE trades higher than 36.75, our Stop order is triggered and turned into a market order. This means that you will receive the next available price, which may or may not be 36.75 (*see illustration 2*).

Let's get back to our original GE sell stop.

In addition to a Day and GTC duration Scottrade has recently unveiled a GTD – Good Till Date duration. This duration allows us to pick our day and time when we would like the order to cancel. Let's take a look. In the example below we clicked on the calendar and selected May 7th as our Good Till Date.

Next, the pull-down menu allows us to pick the time of day that we want the order to cancel by the half hour, in this case 4:00 p.m. E.S.T.

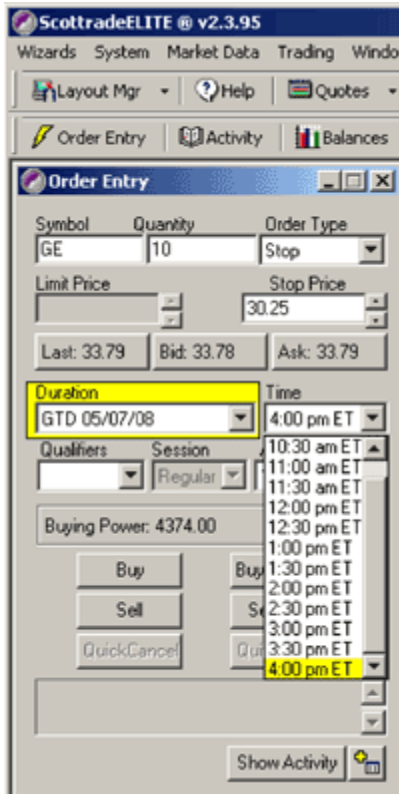


Illustration 3

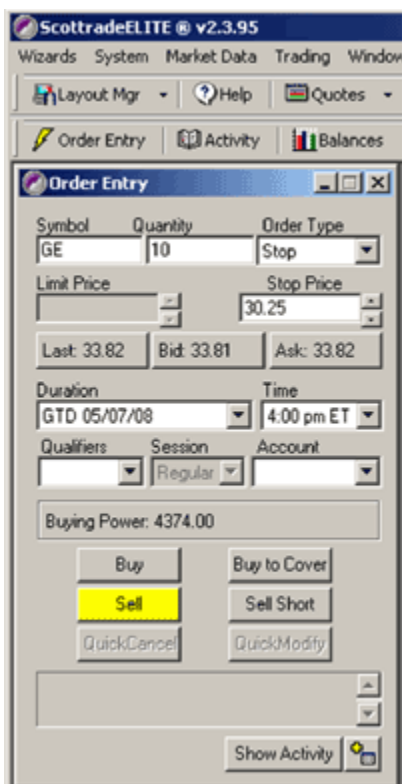


Illustration 4

Finally, we have all of our fields selected and we are ready to review our order (*see illustration 3*).

Looks like a perfectly good stop order – you are now ready to click the “**Sell**” button and then place your trade! (*see illustration 4*).

Stop Limit Order

A Stop Limit order is a type of order that combines the features of Stop order with those of a Limit order. A Stop Limit order will be executed at a specified price (or better) after a given Stop price has been reached. Once the Stop price is reached by the market, the Stop Limit order becomes a Limit order to buy (or sell) at the Limit price or better. This order is then handled as defined by a Limit order. The primary purpose of a Stop Limit order is to give you more control over where the order should be filled. The downside, as with all Limit orders, is that the trade will not be executed if the stock does not reach the Limit price. These types of orders may be placed with special instructions, like AON (all or none) and GTC (good until cancelled). Stop limit orders are used by some investors to buy a stock when it reaches a certain price, allowing the investor to buy when the stock has upward momentum behind it.

For this example we only want to sell our GE if the price drops to 29.75, but we don’t want to sell at a price lower than 29.75. A regular Stop order becomes a market order as soon as the Stop price is reached. However, a Stop Limit order becomes a Limit order once the Stop price is reached. In this example we are going to only sell our position if the price of the stock drops to

29.75. Then the stock must trade at 29.75 or higher. This order takes a little time to reason through. Just like a Stop order, a Stop Limit order must be triggered. After the trigger this order type then turns into a Limit order. Let's take a closer look.

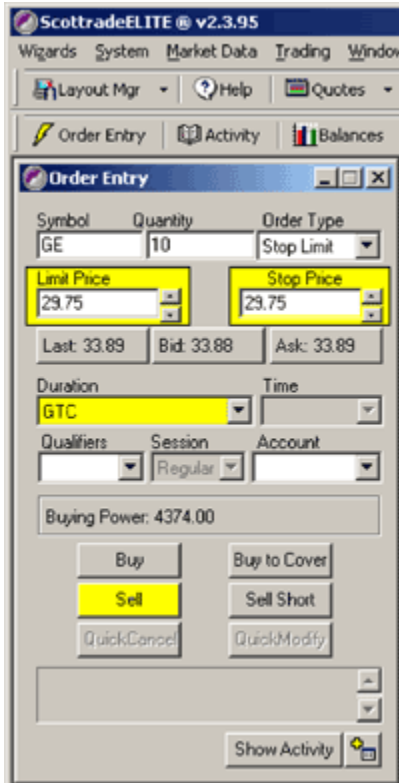


Illustration 5

After you enter the symbol and the number of shares, next select “**Stop Limit**” from the drop down box next to Order Type. As soon as you select Stop Limit for your order type, the Limit price field will appear. Both fields are mutually exclusive and do not require similar prices. In this example, we have decided to have our Stop price and our Limit price exactly the same (*see illustration 5*).

We have decided to use GTC duration for this order.

As a refresher, once GE trades at 29.75, the Stop Limit order is triggered and the order becomes a plain old Limit order with a limit price of 29.75. Let's not forget that a Stop Limit has the potential for triggering and never filling if the stock never travels at or higher than our Limit. This is important and could lead to frustration if not understood. Click the “**Sell**” button and your Stop Limit order will be on its way.

I hope these illustrations and explanations have provided a clearer understanding of investing with Scottrade using Stop and Stop Limit order types, and I wish great success. Happy investing!