UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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ADMINISTRATIVE PROCEEDING
File No. 3-16795

In the Matter of
JOSEPH J. FOX,
Respondent.

Respondent Fox's Reply Division's Supplemental Brief in Support of its Motion for Summary Disposition

In accordance with the Courts permission to allow me to file a reply to Division of Enforcement's supplemental brief addressing the *"limited issue of Respondent's scienter"*, respondent Joseph J. Fox respectfully replies as follows.

In the Order Requesting Supplemental Briefing on January 15, 2016, the court determined that ***"the Division's motion and its reply brief appear to lack any discussion of Respondent's scienter, one of the factors I must consider when determining whether the sanction's sought by the Division are in the public interest"*** and that ***"my evaluation of this factor would be aided by additional information."***

In the Supplemental Briefing, the Division failed this courts demand to provide any new facts or information to prove that I acted with scienter. The Division's new argument that sometimes ***"Recklessness can satisfy the scienter requirement"*** is unavailing. In addition, the Division tries to move the goal-post by arguing that ***"It is not necessary to find that the respondent acted with a certain level of scienter for a sanction to be in the public interest."***

The Division argues that I ***"acted at least recklessly in violating the securities registration provisions"***. Yet, they only repeat the same claims that the court has apparently determined to be unavailing. In my response to the summary disposition, I laid out in detail the legitimate facts that prove that not only were any violation done so inadvertently, they were not done so in a reckless manner. Specifically, that when taking Web Street, Inc. public in 1999, the SEC did not report any issues with identical facts regarding financial disclosures to non-accredited investors. Nor did our counsel or the underwriters' counsel ever raise the possibility of any securities law violation.

The Division states ***"At the time Fox committed the registration violations in question, he was an experienced securities professional."*** While, this is an accurate statement, I would add the word "conscientious". As stated in detail in my response to the motion for Summary Disposition, I have gone out of my way my entire career to put the interest of my customers, shareholders and regulators ahead of my own.

For reasons I struggle to understand, the Division tries over and over again to minimize all that I have done over the past 22+ years and to put me in a negative light. The Division states correctly that I have ***"spent a substantial portion of [my] career in the securities industry as the Chief Executive Officer of two registered broker-dealers"***, yet completely omits the fact that I had an absolute spotless compliance record as it pertains to customers, investors, FINRA and the SEC itself.

The Division goes out of its way to falsely label me as some kind of unrepentant recidivist when they state that I had a ***"lengthy career in the penny stock world"***. There is no denying what they meant by this. A simple Google search of the term ***"penny stock world"*** results in story after story of the fraudulent world of penny stock schemes. (Exhibit # 1)

One would have thought that the Division would have done even a cursory review of my history as an ***"experienced securities professional"***. If they would have done so, they would have discovered that in the 22 years since I first received my Series 7 license, I never once sold or promoted a single share of ANY penny stock. Going one step further, Ditto Trade in its five plus years in business never allowed a customer to even get a quote on a stock that traded on the OTC Bulletin Board or Pink Sheet. (Exhibit # 2)

The Division states in its Supplemental Brief in Support of its Motion for Summary Disposition that ***"He has not provided any assurances against future violations or accepted any responsibility for his actions."*** However, just 19 days earlier in the Divisions Reply in Support of its Motion for Summary Disposition, the Division states the opposite when is says, ***"although Fox indicates that he does not plan to affiliate with a registered broker-dealer in the future, he provides no <u>similar assurances</u> against associating himself with other industry participants or penny stocks in the future." (emphasis added)***

There is a perfectly good reason why I didn't include ***"similar assurances against associating myself with other industry participants or penny stocks in the future."*** That is because while I have indeed spent a good portion of the past 22 years associated with a registered broker-dealer, I have <u>never</u> been associated with an "investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization", nor have I <u>ever</u> participated in any penny stock offering.

So, for the sake of clarity, in addition to having no plans to work for a registered Broker/Dealer, I also do not plan to work for an investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. Nor do I have any plans to begin participating in any penny stock offering. However, the fact that I have chosen to not participate in any of the segments of the securities industry that are covered in a collateral bar, does not mean that I can willingly accept (or deserve for that matter) any type of industry bar based on mischaracterizations of the facts.

The Division has stated that ***"Fox's occupation will provide him with significant opportunities for future violations"***. This statement unavailing since, a) I voluntarily withdrew all of my brokerage licenses in December 2014, b) the Division knows full well that I tried to withdraw my licenses as early as January 2013 when we hired Paul Simons to take over as CEO of Ditto Trade, so I could focus my energies as the CEO of Ditto Holdings (unfortunately, I was forced to stay on as CEO as Simons failed to take the required General Securities Principals exam during the 8 ½ months he was employed by us), and c) the Division was fully aware that due to lack of capital Ditto Trade had to cease operations and withdraw its Broker/Dealers license on December 18, 2015.

While the description of Regulation D may be ***"plain language"*** to the Division, it certainly is not to most, if not all laypersons. In addition, the Divisions provides a link to the Series 7 and 24 outline on the FINRA website and claim that because I held both Series 7 and 24 licenses I should have known all there was to know about the differences between a 504 offering and a 506 offering.

What the Division fails to mention, and as you will see by the attached excerpt from the Securities Institute of America exam preparation study guide for the Series 7 license, there is no mention whatsoever about financial disclosures (or any disclosures for that matter), let alone the disclosure requirement differences between a 504 offering and a 506 offering. (Exhibit # 3) I am extremely confident that other major study guides have similar basic facts about disclosure requirements.

As someone who has taken and passed the Series 7 (and 24) exam twice, I can assure the court that the exam itself does not dig any deeper (than the study material) into the disclosure requirement differences between a 504 offering and a 506 offering.

How can the Division claim that I had not "***accepted any responsibility for his actions***"? Specifically, when the Division knows full well that (at the beginning of the Divisions investigation in 2013) after realizing that the disclosure requirements for 504 and 506 as it relates to non-accredited investors were different and that we did not provide enough disclosures to non-accredited investors, I immediately told the Division that I took responsibility for this mistake. In addition, during the settlement discussions with the Division, I made it clear that I accepted responsibility for selling some of my shares to 2 non-accredited investors. On several occasions, I offered to repurchase the 39,227 shares (for the $43,150 that they paid) from these 2 purchasers. The Division chose not to make that part of any monetary sanctions.

When the Division states that ***"Fox attempts to mitigate this fact by pointing to the subsidiary company's financial statements"***, they omit several key facts that they were aware of. First, this "subsidiary" had their financial statements audited since its inception in 2010. Second, this was the <u>sole operating subsidiary</u> of the holding company. Lastly, it was our only source of revenue. While I am now fully aware that we needed to provide audit statements for the <u>entire</u> Company under Rule 506, I do believe it does speak to scienter.

In conclusion, I took responsibility for what occurred and have repeatedly assured the Division that I would absolutely never intentionally or unintentionally violate any securities laws. Most importantly, the Division failed to provide any new facts to prove that I acted with scienter no matter how liberally one defines the term.

I have already agreed to a $205,636 fine and the Company that I founded (and that in late 2013 had a valuation of $40+ million) is now out of business due to the weight of the malicious efforts of a former employee.

Accordingly, I respectfully submit that the five-year collateral and penny stock bar sought by the Commission is not in the public interest and the Division's Motion should be denied.

Dated: February 19, 2016

Respectfully submitted,

Joseph Fox

Joseph J. Fox

Exhibit #1

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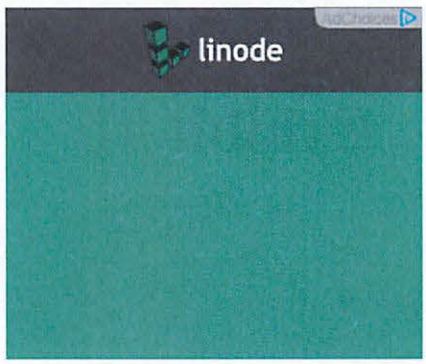
How To Buy Penny Stocks (While Avoiding Scammers)

INVESTOPEDIA By **Elvis Picardo, CFA**
August 27, 2015 7:21 PM



Let's face it, who wouldn't like to get in on a stock that trades for mere pennies but over time ascends to stratospheric levels, resulting in gains of tens of thousands of dollars? That's the central allure of penny stocks – the fact that you can buy a large number of shares in an early-stage company for a relatively small amount and possibly sell those shares for a much higher price if the company's plans succeed. In reality, however, the handful of penny stock companies that have executed their game plan to perfection, and enriched their investors, are vastly outnumbered by those that went bankrupt and wiped out shareholder value.

Trading penny stocks is ***not*** for new investors or those with a low tolerance for risk. That said, if you want to trade penny stocks and are willing to stake a tiny proportion of your portfolio on them, following the measures below can enable you to at least preserve most of your trading capital. And with some luck, you might even score the occasional winner.

"Penny Stock" Definition

Let's start with the basic definition of penny stocks. The Securities and Exchange Commission (SEC) defines a penny stock as a "security issued by a very small company that trades at less than $5 per share." The SEC notes that such stocks are generally quoted over-the-counter, such as on the OTC Bulletin Board (BB) or the OTC Link (previously known as the infamous "pink sheets").

The SEC further divides penny stocks into "microcap stocks" –

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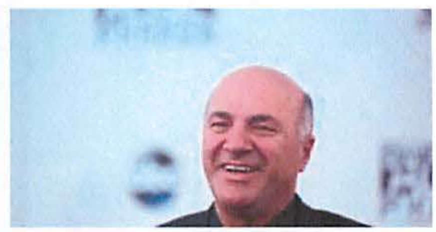

Kevin O'Leary's next big market move

Drivers With No Tickets In 3 Years Must Read This

Can this 24-year-old survive 24 hours without the Internet?

Guide for Investors").

You also should distinguish between penny stocks and "fallen angels." The latter are former blue-chips or high-fliers that have encountered hard times and are now trading at prices in the low single-digits. Examples include low-priced stocks that trade on the OTC (for example, Fannie Mae and Freddie Mac) or on other exchanges like the Nasdaq (for example, Groupon Inc. (GRPN), since they have substantial businesses and market capitalizations in excess of $1 billion.

The main parameters that define a penny stock are (a) the company's very small size (in terms of revenues or number of employees) and (b) the fact that they trade on the OTC BB or OTC Link. Although penny stocks are indeed often priced in pennies, a successful promotion can drive a penny stock well above the $5 threshold and give it a substantial market cap for a fleeting period.

For example, in the summer of 2014, an OTC stock Cynk Technology (CYNK), whose company had no assets or revenues and only one employee, soared from six cents to an all-time high of $21.95 per share, gaining 36,000% and creating a market cap in excess of $6 billion. That inflated market cap lasted for all of one hour, as on July 11, 2014, the SEC suspended trading in the stock for two weeks due to concerns about the accuracy of its disclosures and potential market manipulation. Cynk shares subsequently plunged more than 99% from their brief high and were trading at 15 cents in late August 2015.

How To Avoid Scammers

Certainly the penny stock world is rife with market manipulation, fraud and chicanery, but investors should know that such abusive practices aren't the exclusive domain of penny stocks and micro caps by any means, as the cases of scandal-ridden companies like Enron and WorldCom well prove. That said, how can you avoid being scammed by dishonest penny stock promoters who are out to make a fast buck? Here are some suggestions:

- **Know the difference between promotion and research.** Promoters routinely hire newsletter writers to write flattering reports about their stocks. Many of these writers make a convincing case for investing in dud penny stocks, using hyperbole, outlandish projections and, in some cases, deliberate distortion, as these promotional pieces look very similar to sell-side research reports. The penny stock investor has to learn to distinguish between stock promotion and legitimate equity research. One way is to read the "disclosures" section at the end of the report, and see whether the writer is being directly compensated (often in a combination of cash and stock) for the report by the company they're recommending. If that's indeed the case, this is essentially an advertisement, not an actual research report.

Jobs running a penny stock company, you should still delve into management's track record to determine whether company executives and directors have had any notable successes or failures, regulatory or legal issues and so forth.

- **How do the financials look?** Although penny stocks generally don't furnish in-depth financial information, it won't hurt to check the financial statements the company does release. Scrutinize the balance sheet to learn if the company has any substantial debt or liabilities outstanding, as well as its amount of net cash on hand. If the income statement shows a huge growth in revenues of late, that's one promising sign (for more, read: The Most Crucial Financial Ratios For Penny Stocks).
- **What's the quality of disclosure?** The more disclosure the company provides, the better, as that indicates a greater level of corporate transparency. For instance, the OTC Markets Group divides its securities into a three-tier marketplace: OTCQX (the top tier), OTCQB (middle tier) and OTC Pink, based on the integrity of a company's operations, its level of disclosure and its investor engagement. Since OTC Pink company reporting can be spotty, OTC Markets Group further segments that group, based on the quality and quantity of information provided, into Current Information, Limited Information and No Information. Obviously, investing in a company with limited or no information is best avoided, as the phrase "no news is good news" doesn't apply in the penny stock world. In addition, stocks for which OTC Markets Group advises investors to exercise additional care and thorough due diligence typically flash a skull-and-crossbones " Caveat Emptor" sign. Penny stocks may earn this symbol for a number of reasons: the company or its insiders may be under investigation for fraudulent or criminal activity, or the company may be involved in such dubious promotional activities as spam emails.
- **Is the business plan achievable?** Investors should evaluate whether the company's business plan is achievable and if it actually has the asset base it professes to have. Recall the infamous case of Bre-X, the Canadian junior miner that in the 1990s claimed to have found one of the world's biggest gold mines in Busang, Indonesia: a story that turned out to be a colossal fraud (for more, read: The Biggest Stock Scams Of All Time). Before it was found out, Bre-X shares climbed from 12 cents to C$280. Its collapse in 1997 wiped out C$3 billion in market value, and likely a fair share of penny stock investors.

How To Buy Penny Stocks

Once you've learned to dodge scammers, here are five steps to follow when purchasing a penny stock.

1. **Evaluate whether the stock has upside potential**: You're investing because you'd like to get a return, right? So you need to ask yourself whether the penny stock you're considering truly has upside potential, or if it seems more to be a flavor-of-the-day kind of stock, such as a company's that's trying to ride the coattails of the latest investment fad.

2. **Limit your holdings and diversify**: You might be excited about the prospects for your favorite penny stock, but you still need to protect yourself. Cap your losses by limiting your holdings in the stock to no more than 1% or 2% of your overall portfolio. It also makes sense to diversify your penny stock portfolio, which shouldn't exceed 5% to 10% of your overall portfolio, depending on your risk appetite.
3. **Check liquidity and trading volumes**: Even if you've made a successful investment in a penny stock, you're going to need to be able to sell your shares. You should have adequate liquidity and trading volumes in the stock so that you can trade it efficiently. Otherwise you may wind up in a situation where there are few buyers and wide bid-ask spreads, making it nearly impossible to convert your paper profit into an actual one.
4. **Know when to sell**: It's very rare for a penny stock to be a long-term buy-and-hold investment. The sector is built on short-term trades, so it's as important to know when to sell as it is when to buy. If you notch sizeable gains over a short period of time in a penny stock, consider booking them now rather than waiting for bigger profits that may never materialize.
5. **Search for high-quality stocks**: Basically, some penny stock companies are worth more than others. Good prospects include ventures that are set up by experienced managers who have successfully exited a previous company; stocks with binomial outcomes (such as biotechnology stocks or promising resource companies) and fallen angels. If getting a low stock price is driving your investment decision, then fallen angels – which appear in abundance towards the end of a bearish trend, whether in a specific sector or the overall market – are among your best bets (although strictly speaking, they're not really penny stocks). Many leading technology stocks today were trading in the low single-digits at the end of the 2000-02 "tech wreck," while household names like Citigroup Inc (C) and La-Z-Boy Inc. (LZB) traded below a buck in March 2009.

The Bottom Line

Penny stocks are extremely speculative investments, and should be approached with caution and with a strong investment and trading strategy in place. By following the measures outlined here, you can avoid scams and invest methodically, thus improving your chances of success in this risky arena.

Rates

4 Ways to Avoid Penny Stock Scams

By Elvis Picardo, CFA | September 09, 2015

Despite tightened disclosure and reporting requirements for companies listed on the Over-the-Counter (OTC) Bulletin Board in recent years, penny stock scams continue to trap unwary investors. If you want to avoid losing your hard-earned money to such scams, follow these four rules. (For more, see How To Identify A Micro-Cap Scam.)

1. Conduct Extensive Due Diligence

In general, investors do not spend enough time researching a stock before buying. While this is a risk when buying a blue-chip stock on the Nasdaq or the New York Stock Exchange, it is downright reckless to do with penny stocks. The degree of due diligence required to unearth all the facts and separate the truth from the hype is much higher with penny stocks than with blue-chip stocks. Like most investors, you may feel that you need to act quickly to get in on a stock before it starts rising and gets too expensive, but spending a few hours researching a penny stock before buying is time well spent. Even if the stock price rises during your research, the additional dollars you spend in buying the stock at a higher price will be more than offset by (a) the potential losses you avoid by dodging a dodgy stock and (b) the peace of mind acquired in knowing you conducted due diligence. At a minimum, your due diligence should extend to checking management's past record and accomplishments (or lack thereof), the company's financial statements (generally available on the company's corporate website or other financial websites) and U.S. Securities and Exchange Commission (SEC) websites to check if the company is current in its filings and that there are no regulatory actions against it. You should also do a general online search to unearth anything else—positive or negative—on the company. You may be surprised at the number of red flags that crop up around your slam-dunk penny stock. Your odds of being taken in by a scam will be significantly reduced if you conduct extensive due diligence before investing in a penny stock.

2. Beware Penny Stock Marketing Traps

As technology has evolved, unscrupulous penny stock promoters have become more creative in their marketing efforts. Due to the growing redundancy of faxes and use of National Do Not Call registries, traditional selling techniques like fax blasts and cold calls emanating from boiler rooms (as seen in "The Wolf of Wall Street") have been supplanted by social media marketing and stock pitches "mistakenly" left on personal voicemail. You can stay away from these marketing traps by following a few simple precautions. Register all your phone numbers on the U.S. Federal Trade Commission's National Do Not Call registry by going to donotcall.gov or by calling 1-(888)-382-1222 to avoid being pestered by cold callers. Stay away from bulletin boards and social media sites that focus on penny stocks. Finally, never ever respond to an e-mailed stock marketing pitch (or better still, block or delete such e-mails

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instantly). If despite these precautions, you still receive a hot tip from another source (such as a friend or acquaintance, or a direct pitch from a promoter), politely decline the opportunity even if it appears tempting.

3. Learn to Spot Hype and Misinformation Masquerading as News

Do not get fooled by bullish newsletter reports that masquerade as unbiased research. If the newsletter writer is being paid by a promoter to write up a specific company, what are the chances that the ensuing report is going to be objective and highlight the risks of investing in the stock? Similarly, news releases that serve no purpose other than to boost the penny stock should be ignored. In the penny stock world, there's no such thing as being too cynical.

4. Become a Better-Informed Investor

Low-priced stocks, especially those that trade below a buck, have an undoubted appeal. But rather than making the newbie mistake of only looking at the stock price, check the stock's market capitalization as well. This may provide additional insights into the stock's valuation. For instance, a 50-cent stock with 500 million shares outstanding would have a market cap of \$250 million, which is twice as much as that of a \$5 stock with only 25 million shares outstanding. If both companies have annual revenues of \$5 million, the "cheaper" 50-cent stock is actually twice as expensive as the \$5 stock on a price/sales basis. (price/sales is equivalent to market cap/ total sales, so for the 50-cent stock, P/S = \$250 million / \$5 million = 50, while for the \$5 stock, P/S = \$125 million / \$5 million = 25; the higher the ratio, the more expensive the stock as a multiple of sales). Studying valuation and portfolio techniques will help you become a better investor and pay dividends in the long run (to learn more, see this tutorial on Investment Valuation Ratios). If you find low-priced stocks especially alluring, becoming an informed investor will be useful in identifying so-called fallen angels. These are former high fliers traded on regular exchanges that have slumped to record lows due to specific challenges or broad market or sector conditions. With these stocks, you can enjoy the low prices of a penny stock without the attendant risks like low liquidity, limited disclosure, shaky financials, few assets and little-to-no revenues. While many fallen angels will never recover, unlike penny stocks, they at least have a proven history of success in the past. Some of them will manage to turn around their performances, resulting in an exponential increase in their stock price for investors.

The Bottom Line

Penny stock scams still abound, but you can avoid them by conducting extensive due diligence, staying away from the usual marketing traps, learning to identify hype and misinformation and becoming a better-informed investor.

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MarketWatch

10 ways to trade penny stocks

By Michael Sincere
Published: Feb 3, 2012 12:01 a.m. ET

Commentary: Respect risks, ignore hype, and follow these rules

MIAMI, Fla. (MarketWatch) — The allure of penny stocks is simple: They don't cost much money and promise big profits. But trading penny stocks is also a good way to lose money.

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Omar Aguilar, chief investment officer at Charles Schwab, tells MarketWatch's Jonathan Burton investors are transitioning to a search for growth from a flight to quality.

Sure, it's possible to profit when you understand the game, but the odds are against you when you don't. And worse: manipulators and scammers often run the penny-stock game.

For investors who can't afford shares of Google or Apple, the potential gains from trades like this are too good to pass up. So penny-stock trading thrives. With a relatively small investment you can make a nice return if — and this is a big if — the trade works out. For example, say you buy 10,000 shares of a $.30 stock for $3,000. If the stock reaches $1, you've made $7,000, doubling your money. Read more: 5 strategies if you have less than $3,000 to invest.)

Dollars and sense

Penny stock promoters make sure to attach a disclaimer to their email, Twitter, or Facebook page, and take advantage of this language to embellish and deceive. Read more: Stock touts prey on investors' inflation fears.

Penny stocks and their promoters also tend to stay one step ahead of securities regulators, though just last month the Securities and Exchange Commission charged a Florida-based firm, First Resource Group LLC, with penny-stock manipulation. Read more: Simple rule: Don't buy a penny stock.

Even with these clear dangers, some people insist on trading the pennies. So, if you find yourself on the receiving end of a telephone call from a penny-stock promoter, or you spot an advertisement that promises dollars from your pennies — and you still decide that maybe penny stocks aren't wooden nickels, just remember these 10 rules:

1. Ignore penny-stock success stories

Timothy Sykes, a penny-stock expert who trades both long and short, says you must not believe the penny-stock stories that are touted in emails and on social media websites.

"You have to say no," Sykes said. "You can't invest in penny stocks as if they were lotto tickets, but unfortunately that's what most people do, and they lose again and again. Think of penny stocks as inmates in a prison that you can't trust."

Instead, Sykes says, focus on the profitable penny stocks with solid earnings growth and which are making 52-week highs.

2. Disregard tips and read the disclaimers

Penny stocks are sold more than bought — mostly via tips that come your way in emails and newsletters.

Facebook IPO: What could go wrong

(4:40)
What could trip up Facebook's march to one of the biggest IPOs in history? Shira Ovide discusses on digits. Photo: Getty Images.

"The free penny-stock newsletters are not giving you tips out of the goodness of their heart," Sykes said. "If you read the disclaimers at the bottom of the newsletters, they are getting paid to pitch a stock because their investors want exposure for the company. There is nothing wrong with wanting exposure, but almost all penny newsletters make false promises about their crappy companies."

Sykes says there is a difference between stocks making a 52-week high based on an earnings breakout and stocks making a 52-week high because three newsletters picked it. Reading the disclaimers at the bottom of the email or newsletter, which the SEC requires them to do, will usually reveal a conflict of interest.

"Most newsletters don't tell you the truth," Sykes said. "They are being compensated to pump up the stock, and they rarely tell you when to sell. Often it's far too late."

3. Sell quickly

One allure of penny stocks is you can make 20% or 30% in a few days. If you make that kind of return with a penny stock, sell quickly.

Unfortunately, many traders get greedy, aiming for a 1,000% return. Considering that the penny stock you're in might be getting pumped up, take any profits and move on.

4. Never listen to company management

In the murky penny-stock world, don't believe what you hear from companies.

"You can't trust anyone," Sykes said. "The companies are trying to get their stock up so they can raise money and stay in business. There is no reliable business model or accurate data, so most penny stocks are scams that are created to enrich insiders."

Sykes says large rings of the same people run promotions using different press releases and companies, including the reappearance of a notorious stock manipulator who was first convicted for an email pump-and-dump scheme when he was in high school.

5. Don't sell short

Although shorting pumped-up penny stocks may seem attractive, don't do it.

Penny stocks are too volatile, and if you're on the wrong side of the trade, you could easily lose 50% or more on a short squeeze. Another problem is that it's difficult to find shares of penny stock to short, especially those that made huge moves based on hype and newsletter tips. Leave shorting penny stocks to the pros.

6. Focus only on penny stocks with high volume

Stick with stocks that trade at least 100,000 shares a day. If you trade stocks with low volume, it could be difficult to get out of your position.

"You must be aware of the number of shares traded and the dollar volume," Sykes said. He also suggests that you trade penny stocks that are priced at more than 50 cents a share. "Stocks that are trading less than 100,000 shares a day and are under 50 cents a share are not liquid enough to be in play," he added.

7. Use mental stops

Because the bid-ask spreads on many penny stocks can be high, as much as 10%, hard stop-losses can actually cause you to lose money.

Although it takes more concentration, use mental stops. "I focus more on risk-reward than stops," Sykes said. "If I want to make a dollar a share on a three-dollar stock, I will cut my losses at 20 cents so I have a 5:1 risk reward. I aim for 3:1 or 4:1, but not 1:1 or 2:1. If I think a dollar stock has only 50-cents upside (2:1), my mental stop loss will be at 10 cents because the risk-reward is better."

8. Buy the best of the bunch

Sykes looks to buy penny stocks that have had an earnings breakout.

"I love buying penny stocks when they have good earnings, or when they are breaking out to 52-week highs on volume that is at least a quarter million shares a day," he said. "They are easy to find if you look."

The challenge is to find stocks that make 52-week highs that aren't due to a pump-and-dump scheme. Examples of penny stocks that have fit Syke's criteria in the past include Tangoe TNGO, +9.17% , Magal Security Systems MAGS, -1.42% , and Staar Surgical Co. STAA, +0.59% .

9. Don't trade large positions

"You really need to be careful with position sizing," Sykes said. "I learned the hard way not to trade big. My rule now is not to trade more than 10% of the stock's daily volume."

In addition, he said, limit your share size so you can get out of the stock faster.

10. Don't fall in love with a stock

Every penny stock company wants you think it has an exciting story that will revolutionize the world. If you enter the penny stock arena, be cynical, do your own research, and diversify, even if a friends or family member is touting a stock.

Penny stocks have earned their bad reputation, so beware.

Michael Sincere (www.michaelsincere.com) is the author of "Understanding Options," "Understanding Stocks," and "Start Day Trading Now."

More from MarketWatch

Exhibit #2

ELECTRONIC INVESTOR

Day Trade and Keep Your Day Job

A new online brokerage firm, DittoTrade, lets you mimic the trades of professionals—and get the same prices they do.

By THERESA W. CAREY
Updated May 7, 2011 12:01 a.m. ET

A new online broker is opening with an interesting twist. Aside from the usual online features, DittoTrade lets you buy and sell right alongside an experienced trader.

DittoTrade's CEO, Joseph Fox, has prior experience operating an online brokerage firm—he was a founder of Web Street Securities, which was a top-rated broker in *Barron's* annual ranking back in the late 1990s and was acquired by E*Trade (ticker: ETFC) in 2001. Fox decided during 2008's financial meltdown that he wanted to go back into the business, mainly because he believed individual traders were getting clobbered by institutional traders using algorithms and high-frequency techniques.

His fledgling firm (www.dittotrade.com) opened its virtual doors in a beta test last October, but will soon be more visible, thanks to a new marketing campaign (and, no doubt, articles like this one). Fox says the idea is to let average investors, who usually have better things to do than stare at a computer screen, benefit from the skills of people who are in the market every day.

Upon logging in, you are presented with a standard-looking account balance page with streaming quotes. The "Trading Pit" is where customers can place orders on their own; like tradeMonster, when you enter a position on DittoTrade, you are encouraged to set a stop-loss and a profit target. Things start to differ, however, if you connect to a Master Trader.

THE MASTER TRADER LINK takes you to a dashboard that shows the stocks your chosen trader is monitoring. Most of the master traders attach notes to each symbol on this watch list, which often includes their thinking about a particular stock, along with an explanation of price entry and exit points. There are two ways to join into a master trader's transactions: Full Throttle, which means you take part in every transaction entered by the master trader, or Participation Mode, which means you pick which stocks you want to trade from the master trader's watch list.

You can also define in advance how you want to take part. You can choose from Share for Share (trade the same number of shares as your master trader), Percent for Percent (trade the same percentage of your total account as your master) or Max Loss Per Trade (set an amount you're willing to lose should the stock price hit its stop-loss). The DittoTrade engine calculates these measures for you, and bundles your transactions together with those of the master and all of his other minions. Everyone gets the same price at the time of execution, which distinguishes DittoTrade not only from traditional online sites but from those offering other trade-mirroring technologies.

Once you've opened a position, you can either follow the master trader to close the position, or close it on your own. You can also detach the position from the master trader's dashboard and hold it separately.

Some *Barron's* readers may be wondering how they can become master traders. Fox says his brokerage is actively seeking more masters, and also is looking for those with international trading expertise. You can reach him at jfox@dittotrade.com. Master traders typically charge a subscription fee to their followers, and they control which DittoTrade customers are allowed to "ditto" their transactions. You can also develop a "friends and family" following. That means you aren't publicly visible like a master trader, but your nephew or mother-in-law can trade with you.

San Diego-based Andy Lindloff of todaytrader.com is one of the existing master traders. DittoTrade clients can follow Lindloff for $99 per month for Full Throttle access, or they can sign up to be alerted when he makes a trade, for $49 per month. If you choose the alert system, you can make the trade on your own, but it won't go through in a bundle with Lindloff's orders.

Last year, the New York Times featured Lindloff in a story about the death of day trading, which brought him to Fox's attention. Now Lindloff and his partner, Steve Gomez, are on board with DittoTrade. They generate approximately 30 transactions per month with their trading system, and customers can also watch Lindloff trade in real time using GoToMeeting, the screen-sharing program for conferencing.

Lindloff, a discretionary trader eschewing algorithms, and Gomez have posted a 28.5% gain over the past six months on DittoTrade, at http://www.todaytrader.com/performance/. He says he enjoys working as a DittoTrade Master Trader: "I think it's a great idea if you find someone —maybe me, maybe your cousin—who is keeping an eye on your stocks and protecting you in the market. If you don't have time, find somebody who is watching the market full-time."

DittoTrade has a logo that Fox calls "the molecule," which he would eventually like to see festooned on many financial Websites. It would let individuals just click on the molecule and start trading alongside their favorite bloggers and professional traders on DittoTrade. Each transaction is $4.95 for stocks and an additional 50 cents per contract for options. Margin fees are a relatively low 4.95%.

Though this site is still a little wet behind its virtual ears, it looks like a good idea worth further exploration and development. It would be worth considering if you're a portfolio manager placing trades for your customers, or if you're managing family accounts. Right now, all you can trade on the site are stocks and options—no mutual funds, penny stocks or foreign ordinaries.

FIDELITY OPENS UP ACTIVE TRADER: Last month, Fidelity (www.fidelity.com) announced it would allow free access for 90 days to its advanced trading platforms to new customers opening an account with $50,000 or more, or to existing clients transferring at least $50,000 into an account. This campaign is called "Go PRO," and the details can be found at www.fidelity.com/goprooffer.

Historically, these are services only available to those who trade more than 120 times per year.

FREE ETFS AT FIRSTRADE: Ten exchange-traded funds (ETFs) can be traded commission-free at Firstrade (www.firstrade.com). Firstrade President and CEO John Liu says, "The 10 ETFs we selected for commission-free trading are designed to allow clients to quickly and easily build a strong foundation for a diversified portfolio."

The list includes three bond funds, several blend funds, a commodity fund and a diversified emerging-markets fund. If you're trading off the free list, commissions are $6.95 per transaction.

E-mail: electronicinvestor@yahoo.com

Exhibit #3

- Regulation A offerings
- Rule 145
- Rule 147 intrastate offerings

PRIVATE PLACEMENTS/REGULATION D OFFERINGS

A private placement is a sale of securities that is made to a group of accredited investors and the securities are not offered to the general public. Accredited investors include institutional investors and individuals who:

- Earn at least $200,000 per year if single.

Or

- Earn at least $300,000 jointly with a spouse.

Or

- Have a net worth of at least $1,000,000 without the primary residence.

Sales to nonaccredited investors are limited to 35 in any 12-month period. No commission may be paid to representatives who sell a private placement to a nonaccredited investor. All investors in private placements must hold the

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securities fully paid for at least six months and sign a letter stating that they are purchasing the securities for investment purposes. Stock purchased through a private placement is known as lettered stock, legend stock, or restricted stock, because there is a legend on the stock certificate that limits the ability of the owner to transfer or sell the securities. There is no limit as to how many accredited investors may purchase the securities. The limits on the amount of money that may be raised under the various regulation D offerings are as follows:

Rule 504 D allows issuers to raise up to $1 million

Rule 505 D allows issuers to raise between $1 million and $5 million

Rule 506 D allows issuers to raise an unlimited amount of capital

The JOBS Act now allows investors to view private placement documents online so long as the website requires an investor to submit a questionnaire documenting assets, income, and investment experience. This questionnaire must be reviewed and if qualified for participation the issuer or broker dealer may assign the investor a username and password granting them access to view the details of the offerings.

RULE 144

This rule regulates how control or restricted securities may be sold. Rule 144

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