

Transcript

THE ARTFUL TRADER

Episode 3: The Aim of the Game. Trading like an athlete with Linda Raschke

Michael McCarthy: The aim of the game is to win. But how? Like an elite athlete, the artful trader needs discipline, focus, and to relentlessly pursue success.

Linda Raschke: It's not just about being smart, it's really about having a certain temperament. Staying that moment, and concentrating, and having complete focus, it's a single mindedness.

Michael McCarthy: Linda Raschke has developed a training regime that would make even an elite athlete break into a sweat. She explains how training and preparation is all important for staying focused on the goal.

Hi, and welcome to The Artful Trader. I'm Michael McCarthy, the Chief Market Strategist at CMC Markets Asia Pacific. Each episode we unlock the secrets behind the highs and lows of the industry's experts, and discover their journey to mastering the art of the financial markets. Today we meet Linda Raschke, one of the world's top players in the investment and trading game. She has been in the industry since 1981, when she began as a market maker in equity options. She features in both Jack Schwager's book, the New Market Wizards, and Sue Herera's Women of the Street: Making it on Wall Street. Linda has been trading for over 35 years. She traded for several hedge funds before starting her own, which ranked 17th out of thousands for best five year performance. It's Linda's commitment, attention to detail and focus that has seen her rise to the top of the game. Today we talk to her about her trading style as we get to the bottom of her game plan. From Chicago we welcome Linda Raschke to The Artful Trader.

So Linda, what was the major reason you got into the industry?

Linda Raschke: Do you want the honest answer, or the snide answer, to make money. I came out of college not really equipped to do a whole lot else. I just sort of fell into it by random. It's not one of those golden chosen paths with gates wide open welcoming everybody in. It's if you can figure out how to get to some firm like that. I found out the hard way, by going to San Francisco, and applying to all the brokerage firms. I figured I'd get a start as a broker. I did not even know the exchange floors existed. I ended up meeting somebody who worked on the San Francisco Stock Exchange, and I had zero idea about stock options at the time, and probably could

have been in a lot of different fields. I wanted to be a music composer, all different sorts of things that you can go into. But I ended up in this one.

Michael McCarthy: So am I hearing you right? All those hours spent at the piano keyboards were one of the key components of you getting into trading?

Linda Raschke: Yes. Because I sucked as a pianist. No, I wasn't that bad. I was actually really, pretty good. I have to say that I've played six hours a day. You'll see a lot of parallels between three types of traders that have really risen to succeed, all in different venues. They were either professional sports players at one point. You have actually had people as well that have had a musical bent. Of course another vein which really was what brought Richard Dennis's original turtle group to the forefront, and why they had so much success. Was because Richard Dennis and his partner were incredibly selective to choose candidates that excelled in game theory.

Actually I have quite a number of friends from the trading floor. At one time they all played in that big grand master's poker, whatever it is, that they hold in Las Vegas every year, where you have to be invited to play. So they just had those types of minds. At lunch upstairs in trading you'd always see people playing backgammon. All these things are based on staying in that moment, and concentrating, and having complete focus. It's a single mindedness. You can't do any of these disciplines if you're multitasking. You can't do any of this stuff if you've got social media blabbing, and the TV is blabbing, and distractions and interference. It takes a lot of concentration. Just as if you're playing chess and thinking number of hops ahead, it's that single minded focus. It's putting on some narrow blinders. That's very important. Because there is so much out there. What you have to do is look at all this other stimulus, and directions, and strategies, and markets, and Bitcoins, seasonals, macro plays, algorithmic plays. They're all trying to pull you away from finding your one game. It really is a game of finding your own way.

Michael McCarthy: So Linda, do you think some traders have a natural talent that they can then develop, or can you start from scratch and become a trader?

Linda Raschke: I think that there are two things. I think if somebody is determined to be successful in a particular area, anybody has the intelligence to accomplish that. I don't believe that you have to have an IQ greater than 125 to make it in this business, and that's not a huge IQ these days. So I really don't think it's a matter of college education either. So already you've got a heck of level playing board right there. It's not just about being smart, it's really about having a certain temperament. The biggest problems to start off with is a lot of people think they want to do this. They think it would be fun, and it's like a game, and they could make a lot of money. But they find out pretty quickly that trading is really not so fun. It can be very, very stressful. You have to have an extremely thick skin. Now with that said, it can be the greatest hobby in the world. I think people have so much fun with it. If they can take

the pressure off of themselves that they have to make a million dollars every year, which is totally unrealistic.

Michael McCarthy: Say we've got a trader whose IQ is high enough, they've got the determination, and the resilience to do it, and they've got a system. What sort of training can they do? How does a trader prepare for game day?

Linda Raschke: The more decisions that you can make before the markets open, the more freeing it is. I know my size I'm going to trade on everything, I know my risk level on everything. I know the markets I'm going to trade that day, and what strategy I'm going to trade that day. It is all decided before the markets open. So I have a process at night, that I go through all those steps to lay out my plan for the next morning. Now in the morning I have a separate process. That separate process is shut down the machine, turn it back on, make sure my execution plot forms are open. You would be surprised, even with the best software or hardware, there are always little glitches; internet, this, that. I make a test run, that I know that all my systems are working.

Then I go upstairs and get my coffee. Then I come down and I make a test trade. But I look to see the rhythm of the night market, and can I make an early S&P trade. There's always one. There's always something that sets up. I've organized my day into chunks of data. So I've got my evening session. If I'm sitting at my desk doing my evening homework, boom, Asia opens, and you get a lot more activity off the opening. Obviously there's the most uncertainty, and you have your largest population. Those are the best times to trade. I have to confess I do not get up for Europe opening, because my beauty sleep does me well when it comes to trading the next session. They've done all these studies on your brain about how you need at least seven hours of sleep. For me it took me 30 years to figure this out, but it does make a difference.

Then the morning session for me starts at pretty much 6:30 central time. It used to be in New York everybody would sit at their desks at 8 o'clock, which means 7 o'clock my time. The bonds would then open, and all these things, and I'd get a little rhythm going. But now you can see that Europe is going into lunch, so people close out positions. They have their counter trend period during that time of day. That's right when we're sitting down at our desks in the US. So there's always two or three really nice opportunities to take advantage of.

Michael McCarthy: So you need a plan. You need an approach. What happens when things go wrong? How do you deal with that?

Linda Raschke: You have to assess several things. Is it something that went wrong from a hardware or software issue that was beyond your control? Those to me are the most unnerving types of things that can go wrong. If I come in and all of a sudden the exchange servers are down, and I have positions on, or just stuff like

that. I guarantee that's going to happen a couple times every year. In some way, some shape your computer blows up. It's frustrating. So for me I know that that's my achilles heel, it's the most frustrating thing for me. Now that I'm aware of it, I'm just like oh my gosh, I've just got to close down, and then I sit there and try not to make mistakes for the rest of the day, because I know I will.

Another type of thing that can go wrong, it's beyond our control, but it's an outlier event. Such as when I had a position on, and the fed announced that they were going to take over Fannie Mae and Freddie Mac, and the S&P opened up 40 points that Sunday night. That's another type of market risk. Perry Kaufman did a lot of studying on these types of events. Like a chernobyl disaster that happened. How do you deal with those? There's a whole protocol for dealing with those types of things. In extreme cases it could actually call for doubling up, believe it or not. But in other cases you just start getting smaller. Once you get yourself smaller. I mean stuff happens, the president could be shot tomorrow, you just never know. But it's beyond your control. But you're in the markets, and the markets have risk.

Michael McCarthy: So you cut the position to take the weight off yourself.

Linda Raschke: Yeah. Take some pieces off. If you really love it, you can put them back on. But most people have a problem doing anything. They're frozen like a deer in the headlights. That is what gets people into trouble. They're sitting there talking inside their head. I know what I should be doing, and their bodies are like granite. That's not a good situation to be in. I think that I could write a little pamphlet, and it would have three paragraphs in it. The number one thing would say, don't freeze, get smaller. You can always get back in, but people think it's an all or nothing situation when they're in. Here is an unfortunate event. If you don't have the tools, and the information to properly assess that event, and the further risks that that event carries, you need to start getting smaller. That mirror process of saying, I don't have to bail out of my whole position, even though you might decide that you want to.

That makes it easier for you to get going. It makes it easier for you to start reducing your size until you are in a workable framework again. Then maybe who knows, you might want to put it back on again. You might want to add. You might want to do different things. But at first you have to get smaller, because you're so clouded, your judgment is clouded. We still have unknown variables. We don't know what the risk is or not. You need to put yourself in a position. These opportunities can often be the best trading opportunities, absolutely. But not if you have a position on, and you're on the wrong side of it. Do you see what I'm saying? So once you can clean up the mess, and downsize it, then you can start trading it again. You would be amazed at how much freer it is, and how much more energy you feel to trade. It actually gets exciting to trade, instead of like, oh my god, I've got this noose around my neck, I fucked up.

Michael McCarthy: Do you come across traders with the other problem, that they overtrade, they do too much?

Linda Raschke: Well traders who overtrade, I don't know, maybe they should lay off the coffee in the morning. A trader who over trades needs to log his trades. Then at the end of the day circle the trades that were reactive trades, where something was getting away from you perhaps, and you were chasing it. Or you got nervous and decided you'd better get out, but then you got back in. So go through your trading activity for three days. All you need to do is do it for three days. Then circle the ones that were emotional, or not planned trades. Look at the money that they cost you, or were you such a genius that they made you money. Evaluate them.

It's pretty eye opening after just three days. Seeing what reactive unforced errors can really cost you in the financial markets. Then go back also and circle the planned trades that were on your game plan that you stopped. That you had the patience for, and see how those come out. I really believe that a person doesn't need a coach, a person simply needs just a few ideas of some basic tools, and they can figure it out themselves. You know what, if they can't figure it out themselves, sorry, this is a game of Darwinism, you're just not going to be around long.

Michael McCarthy: So if you want to get to the Super Bowl badly enough, you can get there.

Linda Raschke: You'll figure out a way. The markets are the best teacher in the world. I think that the markets can dance circles around any educator out there. It really comes down to the individual, how much time they have to put into the work, and how well they are at organizing it.

Michael McCarthy: So Linda, athletes have different coaching or training styles, and the same might be said for traders. What do you think of the school of behavioral finance? Can you use it as a trader?

Linda Raschke: Sure. It's all an awareness about our personal biases. I mean that is what has driven markets forever. It's the supply and demand, the greed, the auction, theory. You can actually study this bias of behavior. Where I could take a room full of 100 traders, show them a candlestick bar in the S&P's that just went from low to high. 80 percent of them will be bullish, not even looking at the previous day's stuff. It's just if it closed at the upper end of its bar, and was a big bar, it does something very bullish to people. Now that in and of itself isn't going to be the basis for a trading strategy. However, you need to be aware of these things in yourself.

So if you find that you are prone to certain, a little bit of getting caught up in the crowd, a little bit of getting too bullish at the wrong spots. Maybe it's too hard to buy when prices are low. That's the beauty of being able to do research. Or on the other hand there's an indicator called the VIX. When the VIX has this spike in it, it's a very strong buy signal. We can see if we went back 20 data points in the past it had a

positive expectation that lasted 22 days in the future. So this type of modeling is always going to be your best tool against the behavioral finance biases that occur. So I don't think you make your strategy per se off of behavioral finance, but you recognize the biases from our human behavior, and then you develop strategies to keep yourself in check.

Michael McCarthy: Linda, you've said you're retired. But from the way you talk about the markets, you still have a passion. I mean you haven't left the playing field, have you?

Linda Raschke: I'm in front of my screens every day. You don't understand, I'm having the time of my freakin' life. I don't have to run a business. Oh my god. The regulatory agencies, and the forms, and the people working for me, 800 numbers, and this and that. I don't like running a business. I'm happy as a pig in shit. I've got my own trading accounts, my own screens. It's nice. I'm just trying to fit too many things into the day still.

Michael McCarthy: But I believe you're transitioning. You train horses don't you?

Linda Raschke: I do. I have four horses. I'm competing them down in Wellington this year. So it's a very big part of my life. That's what really keeps me humble. I mean I go out there. I just had lessons today. It's always very humiliating. I can't sit the horse, I'm bouncing all over. I've been doing this for 35 years. I don't know what will come of that.

Michael McCarthy: So I just want to tease out a little bit more. What parallels do you see between sports and trading?

Linda Raschke: Well obviously if you really want to excel at sports, do not underestimate the amount of practice and time. I wouldn't say that you practice the markets. But I'm sure that if you looked at a top athlete, be it football, tennis, golf, swimming, it's a serious immersion in it I think that is going to ultimately distinguish the ones who have longer careers. You're either emerging yourself into developing systems, or patterns, or research, or some model that's going to give you some edge, or a lot of people came off the trading floor, which was a very intensive environment. I would say that most of them didn't make it, but not everybody is going to make it to the one percent. It's still a numbers game. Some people try to do too much too soon. I do believe that there's really a place for everybody in the markets.

Then the other interesting thing is the continuing PhD that I have gotten in products that have continued to develop. CDS's, or what's this new contract? How did the heating oil behave relative to the gas, relative to the crude in this last hurricane, and why was that? Because oil is transported differently now. Same thing with natural gas that's fracked, now we have pipelines. You're always learning about all this new technology.

Michael McCarthy: You're a successful trader of long standing. But how has the game changed over the years?

Linda Raschke: I think the biggest challenge for people is the electronic platforms make it so easy to click, click, click. And all these studies show that it's absolutely no different than if you're clicking on Twitter, or your Facebook, or likes, or whatever it is. Every time you do a mouse click onto your platform you get a squirt of dopamine in the brain. Just like pulling a slot machine handle in Vegas. I don't know if people recognize that. So it does lead them to overtrade. It does lead them to have a mild addiction. I mean I can see it with myself. I come down at night to do my homework, and I'm starting to put together my game plan. I'm like, well this should be a buy tomorrow. Well I'm looking at it, and all of a sudden I've bought it tonight. It's like, wait, who did that? I didn't put that trade on. Did my hand just go and put that trade on?

With that aside I have to say that the markets in and of themselves really have not changed, especially the longer the time frame that you go out. So if I look at a daily chart now of something, it really could have been a daily chart from 30 years ago as far as I am concerned. On the shorter time frames you certainly have a lot more noise. Perry Kaufman was the best at explaining this, how as more market participants come into the marketplace. Meaning short term traders, retail traders, commercial hedgers, long term trend followers, all those on extremely short time frames, these are signs of a very mature market now. It has got global participation, all different time frames of players. That is what has greatly increased the noise level.

So I'm sure anybody trading the markets knows exactly what I'm talking about. When they get a little bit [? whippy], harder to read, you can't really see the swings. It's marginal land, and you're going to be much more prone to make mistakes. Then of course on the hard time frame sometimes they open them up, and the swings are gorgeous, and the volume is there, and the patterns are much easier to read. So for sure you have to learn to be much more discriminating in the trades that you're selecting. That's hard for people. It's very hard for them to have the patience and sit there. I think it makes it easier if you can find a trading buddy online, or two or three friends on Skype that are about the same level. I think that can be a stabilizing [? 24:42].

Michael McCarthy: Like a training partner.

Linda Raschke: Absolutely. I have a Skype group. There's five of us. I mean I couldn't live without their humor. 99 percent of the conversation has nothing to do with markets. But if there's news, they're instantly popping it in there. Everybody is doing their own thing, but they're sort of sharing what they're doing in a visual sense with the charts. You put a pattern out, and then people can evaluate for themselves. So I do think that that would be most helpful. If people have one trading buddy, or

two trading buddies, then perhaps they can be accountable to each other. That would be helpful.

Michael McCarthy: I just want to pick on something you said a moment ago. Markets are in a very mature state. But at the same time on the shorter time frames, they appear to become more irrational. Is that right?

Linda Raschke: That's exactly what I'm saying. That's noise. That's what I mean by the noise level. A little [25:43] firing off and down, and there's not really any volume. I do believe that the market profile charts could put it into a different type of conceptual framework. I don't really use market profile. That has a lot of value for saying here's all the junk going on in the middle here. Here we have failed auctions up or down. The middle of all this junk, if you get away from it, well you might just come back to it. It kind of gives it a different feel. Instead of if you are trying to evaluate swings, and momentum divergences. Classic early tools like that simply don't work as well on lower time frames, because of the noise levels.

Michael McCarthy: Well Linda, I'm sure our listeners can hear the passion in your voice when you speak about markets. Is it the independence that it offers you that makes you love trading?

Linda Raschke: It really is I think something that you can do yourself. You don't need people to show you stuff. There's so much on the internet. If you just read one book on basic technical analysis, Schabacker, or Wyckoff would give you such a foundation, a real classical foundation. What is support, what is resistance. What is support? Support is two data points. So if you have a swing down, and it makes a swing low, and then a reaction up, that is not support. It has to be tested. So it has to come down, test again, and then come up. So somewhere in there you have two data points. They don't have to be perfect. One could be lower than the other, or higher than the other.

Now what defines a trend? A lot of people say, moving averages, or this, or that. There's a very classic definition of a trend, and so forth, and so forth. And these things you could find on your own on the internet for free, or just one or two of these books. Schabacker. Wyckoff is the best of all in my opinion for understanding the basic structure. Then print out your charts. You make it a little project, just like your third grade teacher assigned you an end of the year project. Take a notebook, print out your ten favorite patterns. Now find 20 more examples of that pattern, and what was the outcome, and how did they look. I will tell you it is more informative to do this type of testing and modeling, where you can see everything by hand, and kind of get a feel for the behavior. This exercise I think will truly make you feel in control, and build up your confidence. Those are my parting words.

Michael McCarthy: This has been fascinating Linda, and a lot of fun.

That was Linda Raschke. For more tips from Linda on how to get game ready, she has written a blog post exclusively for this podcast. Read it now at theartfultraderpodcast.com, where our podcast listeners can also access some limited time offers. The Artful Trader is an original podcast series by CMC Markets, a global leader in online trading. The information in this podcast is general in nature, and does not speak to your personal financial situation. To stay up to date with the new episodes, subscribe now on Apple Podcasts, or wherever you get your favorite podcasts from. Make sure you share it with your friends, and leave us a rating. I'm Michael McCarthy, and this is The Artful Trader.