



We spend a day with Linda Raschke and learn about her trading style, daily market regimen and the challenge of riding a horse in a circle.

BY MARK ETZKORN

keeps up the pace

"Stick an offer out there at 59.25...wait, just offer them out at 59."

Linda Raschke momentarily interrupts her discussion of time frames to put in an order to sell (at 1,059.00) a long scalp position in the E-Mini S&P futures. It's early afternoon and she has spent nearly every minute of the last six hours in the same chair, splitting her time between monitoring charts, posting commentary and trade alerts for subscribers in her online trading room, and trading.

When her order is in the market, Raschke picks up the conversation where she left off.

"When you're scalping, you have to remember the shorter the time frame, the higher the noise level," she says. "And the higher the noise level, the more back-and-fill the market will have and the greater the odds that if you're trailing a stop, your stop will be hit. So for scalp trades, I don't use trailing stops and I exit in one piece.

"You have to recognize how much edge you're giving up just by having the bid-ask," she continues "You'll always do best when you're scalping if you're more conscientious about initial trade entry. It's important to try to buy on the bid and sell on the offer more than 50 percent of the time. That might mean you buy on the bid when you enter and you exit at the market, or vice versa."

Raschke can talk non-stop about trading, often using a ver-

bal short-hand born of years of immersion in her field.

"On a longer time frame, when the power of the trend or momentum is behind you, initial trade location is not nearly as critical," she says. "You put the trade on because you're playing for a longer ride — the most important thing is to not miss that trade. With a trend-following system, for example, maybe 30 percent of the trades are really good and you can't afford to miss those."

Raschke has been a fixture in the trading industry for years as a popular speaker and sometime author (see "Linda Raschke: Top trader keeps it simple," *Active Trader*, August 2000, p. 56). Although she is 23 years into a career that has encompassed everything from floor trading to money management, she does not appear to be heading into an early retirement. Between her personal trading, Web site (www.lbrgroup.com), online trading rooms and occasional seminars and conferences, she's plugged into the markets virtually around the clock. Although Raschke is probably known mostly as a short-term S&P 500 futures trader, she is active in several time frames, markets and trading styles.

In early November 2003 I spent a day in Raschke's trading office. Our conversations took place when she wasn't making trades, attending to her online trading rooms or comparing notes with her staff and fellow traders.

continued on p. 68

**"You have to correct mistakes immediately,
at the market. Any time I don't, I regret it."**

A day in the life

The day begins (for me) a little before 8 a.m. ET, more than 90 minutes before the New York Stock Exchange open. Raschke's home and office are in south Florida's horse country — an interesting blend of rural casualness and suburban modernity. Most of the homes are less than a dozen years old, but many of the local roads are intentionally unpaved to make them more amenable to riding. Miles of crisscrossing white horse fence bracket the multi-acre properties in the area, most of which have built-in stables; many, like Raschke's, also have riding arenas on the grounds.

After saying hello to Raschke's three horses, we walk around back to the office that extends off the back of her house and flanks a pavilioned swimming pool. The trading room is, like her house, airy with high ceilings and filled with sunlight from windows on three sides. One set of doors opens onto the pool and patio; the other opens onto the stables and riding grounds beyond.

Two tiers of computer monitors blanket adjacent walls and a large ViewScan atomic clock perches in the corner where the walls meet. The trading "desks" are large wooden tables on which sit phones, a laptop, printers, keyboards, notebooks, mice (the computer kind) and, occasionally, a long-haired cat (the mammal kind). Two dogs, one big and laconic, the other small and energetic, also wander in and out of the room. Some semi-tropical greenery decorates different corners of the room.

There is no TV — no obligatory financial news station droning in the background. Early in the morning music is playing, but for most of the day the room is filled mostly with the quiet hum of computer drives and air conditioning (it's early November but the temperature still creeps into the low 80s), punctuated by bursts of typing, Raschke's observations about trading and the occasional phone call.

Raschke occupies the chair by the patio door; to her left is her assistant, Harry Devert, who manages the online trading room with Raschke and works various trade orders throughout the day. Before the open, she gives all her computer screens the once-over, checks in with staff (including Dan Chesler, who lives close by, and others in Chicago, New York and Pennsylvania), looks over her analysis and prepares comments for today's trading session.

Price behavior, probabilities and market relationships

After posting her pre-opening comments in the trading room,

Raschke talks about her trading principles, day-to-day approach to the markets and the difference between discretionary and mechanical trading.

"Everything I do is based on actual chart points," she says. "I'm always looking at the swing highs or the swing lows. I never calculate Fibonacci numbers, Gann retracements, artificial pivot points or other things like that because I've never found any edge or any statistical significance from testing them."



Linda Raschke, Harry Devert and Dan Chesler.

"But I *can* quantify chart points," she notes. "I can quantify and test something like, 'If the market made new momentum lows and there's a reaction up by half an ATR (*average true range*), what are the odds the market will trade below that low?' I can determine there's, say, a 68-percent probability of that happening."

AT: Do you use any kind of market or stock selection process along with patterns or strategies?

LBR: Yes. One way to find good potential long-side stock candidates, for example, is to identify the up-trending stocks with the best relative strength at the beginning of a quarter.

A better word to describe it might be the stocks that are "best bid," or "most well-bid." I look at the number of days stocks trade from low to high and how steady their bids are for the two-week period. In other words, I want to see only shallow retracements. So it's not necessarily the stocks that are up the

"If you're trading a very short time frame - scalping - you need really good execution skills and a good platform. Trade like a specialist - buy the bid, sell on the offer and take small gains."

"Momentum is less reliable at volatility extremes, high or low."

highest percentage the first two weeks.

Every quarter the institutions seem to have a theme, and there's an element of crowd behavior — nobody wants to be left behind. So if Abby Cohen, or one of the other powers that be at a particular time decide drug stocks are in, they all have to own drug stocks in their portfolios because they're afraid of underperforming each other. It's really blatant.

The stocks — and I stick to the big-cap stocks in our database — that are best bid in the first two weeks tend to stay the strongest throughout the whole quarter. That group or sector is in vogue, so to speak.

AT: *What's an example of a pattern you use in trading?*

LBR: Here's an interesting one based on a *failed* pattern: If today has the widest range of the past four days and an up close, the odds the low of the bar will be taken out in the next two days is the least-probable scenario.

We came up with a great little system based on that: If you see a wide-range bar with a lower close or a higher close and the high or low of that bar is taken out within two days, it's a signal.

If there was a down-closing wide-range bar and the market takes out the high of that bar within two days, it's a buy signal, because that's the least-probable scenario — it occurs maybe 20 percent of the time. And when the least-probable scenario plays out, there's a very powerful reason why.

AT: *Even though you emphasize the primary role of price action, you still seem to use indicators in certain roles.*

LBR: You have to put indicators in context. They're background information — never the primary reason for a trade.

That said, you can use indicators to objectively scan and rank things. I can create a list of the markets or stocks with the lowest ADX (*average directional movement index — a trend strength indicator*) values on a daily basis, for example. Indicators also allow you to see something very quickly (*she pulls up a chart*). My eye can see a rally in an oscillator, price resistance at the moving average and a little bear flag. If I just look at a plain bar chart, I can't put the price action into context as fast. Indicators can help you process the information a little more quickly.

AT: *But something like that still won't be as objective or mechanical as something like the wide-range bar scenario, which has a definable probability associated with it, right?*

LBR: Absolutely. It is easier to quantify patterns with range functions than it is with indicators, which are derivatives of

price. We evaluate the market in terms of whether there is a high-probability scenario unfolding or if the market is doing the /*rasf*-probable thing, which is valuable information in and of itself.

Sometimes the aberrations and changes in historical relationships are the most powerful signals you can get. For example, if I have 80 years of data that shows a P/E range like this (*she draws a hypothetical range*), and suddenly it changes to this (*she draws a large shift out of the range*), I always want to go with that move. There's always a very powerful reason a market changes a relationship.

The same goes for seasonal patterns or any kind of aberration. I always want to go in the direction of the aberration or adverse move. Every trader I know has had to adapt to a different environment or different market.

Remember during the Gulf War when every 50-cent jiggle in crude oil would move the S&P futures five points? It was a leading indicator. And in the late '90s, there were those five Nasdaq stocks that would always lead the S&P by five minutes or so — all you had to do was watch these stocks to get a good four or five points in the S&P futures.

Today, the asset allocators since the beginning of 2003 have been overweighted in small-cap stocks. The small-cap indices were the first to make new highs and new momentum highs — they have been leading all the way up. I don't think the marketplace has caught on to this so much. For the past four months, the small-cap indices have been our leading indicator for the S&P.

Which goes back to the issues recognizing relationships and experience. Your edge comes in comparing one thing to another: What's the relationship between the S&P and the TICK, between price and an oscillator and so on. When the TICK runs up +1,000 but the S&P only moves up two points, I'm going to be very careful. But if the S&Ps run up 10 points in that same scenario, I definitely want to buy the first pullback.

Remember when the yield curve broke out of its historic range and began to flatten out so much? Everyone was saying, "Oh, it has to go back." Wrong! You always want to trade in the direction of the new highs or new lows in a relationship. That's what blew out Long-term Capital Management (*a high-profile hedge fund headed by a collection of financial academics and other "experts" that collapsed in the late 1990s*).

Mechanical systems

Raschke uses the word "system" regularly, and she has volumes of historical test results and other research at her disposal.
continued on p. 70

"I know now when I'm in a good or bad position.
I know how my body feels."

"One way to avoid biases is by trading other markets."

al. Nevertheless, she's no systematic trader.

AT: *Have you ever been a completely mechanical trader?*

LBR: The closest I ever came was trading a certain system 100-percent mechanically. I barely lasted two weeks — the system generated 10 trades per day. The best success I've had is having someone else do the trades for me.

There's such a small edge in mechanical systems. People don't understand a trend-following system, for example, might go flat for two to three years. You need to be able to trade a lot of systems and a lot of markets [to make mechanical trading work].

Let's say I initiate a long position here on a breakout (*she points to a the top of a wide-range bar on a chart*) with a mechanical system and I'm going to trail a stop at the lowest low of the past seven bars, so if the market moves up I'll keep raising the stop. And say if I test this out, it has a positive expectation — but not a huge one — in every market and every year. But because my initial stop is way down here at the bottom of a bar with an extreme range, the distance between my initial trade location and my risk point is pretty wide.

What I've found with the majority of mechanical systems is they only test out well if you use a very wide stop. If you try to use a conservative stop, you'll get chopped to pieces. The only exceptions are some S&P scalping systems, but with those you're dependent on having a very high win-loss ratio — which you can only get on a very short time frame, playing for a very small objective.

AT: *It's seems like you're talking about different approaches, though, not necessarily right or wrong, in terms of using a mechanical system. Because isn't it valid to say, "I'm willing to assume the increased risk of the wide stop based on the system's projected reward?"*

LBR: Of course. But there's something else to consider. Let's say this system has a win-loss ratio of 60 percent. You think, "Hmm, not bad."

But that's horrible, because the odds of getting five consecutive losers at some point out of a sample size of 200 or so is around 90 percent. So I know if I trade this system religiously I run an incredibly high risk of having five losers in a row — with a large per-trade risk. How much leverage do you think I'm going to use on a system like that? Minuscule.

It's not that it's not a worthwhile trade idea — maybe it is — but the fact that I have large trade risk combined with high odds of five losers in a row means I'm going to have to trade this pattern across 20 markets [to make it viable].

On the other hand, consider a little scalping pattern that has a 92-percent win ratio and shoots for a 75-cent profit in the S&Ps. The odds of getting five losers in a row are much more remote. I can trade 10 times more leverage on that system than I could the first one.

Ultimately, understanding how to use leverage is what makes the difference between the average Joe Schmoe and a superstar trader.

Momentum and volatility

One of the indicators Raschke references when discussing the concept of momentum is a two-period rate of change (ROC), or momentum — the difference between the current close and the close two bars ago. This leads to a discussion about the relationship between momentum, volatility and looking at markets on more than one time frame.

AT: *What's the significance of the two-period ROC?*

LBR: Typically, after two strong readings in an uptrend, [a pull-back will occur].

AT: *What constitutes a strong reading?*

LBR: One that's greater than the readings over the previous three to four weeks. It sort of depends on the individual market and environment, but three to four weeks is a rough way to quantify it.

(*She pages through different charts to find an example.*) Here (*she counts off the ROC readings*): one, two — and there's the pull-back.

This shows up even better on a more volatile index, such as the Nasdaq.

In this case, the market has to test [the previous high] and form a divergence (See Figure 1, opposite page). We're in a trending market; before this can really break down, this has to tick up one more time. You can see the market made really good momentum highs here, pulled back, and there were two trading days from high to low — so I have to look for this to go up one more time.

It might fail — it could gap up one more time and come down. If it had opened flat and made an early push down I would have tried the long side, only because the market had traded from high to low for two days, and there is such a strong tendency for a market to alternate trading from high to low, then from low to high. That's far more powerful in the equity markets, and especially in the index futures, than it is in the cash commodity markets or some individual shares.

Individual stocks can be more trendy. You can see six con-

"10-11:30 a.m. and 2-3 p.m. is when bear and bull flags work best, because that's when institutions are most active."

"People tend to either over trade or under trade – one school or the other."

FIGURE 1 MOMENTUM BUY-DAY SETUP

The two-period ROC had made new momentum highs at the end of October and the market had corrected downward, trading from high to low for two days. According to Raschke, on the morning of Nov. 3 this indicated a buy-day setup. The two-period ROC was poised for a retest of its most recent momentum high, and new price highs were expected on the reaction up. If the market had opened flat or gapped down, it would have been an immediate buy. In this case, the market gapped higher (see inset) and a long trade was entered on the first small pullback (in the S&P futures).



drops off dramatically in certain types of volatility conditions.

An extremely volatile selling climax will mess up the readings on the first reaction. In general, bull and bear flags (short-term consolidations that typically lead to a continuation of the preceding uptrend or downtrend, respectively) work in normal market conditions. But a bear flag, for example, will fail after a volatility extreme like a V-spike reversal because the market will likely make a spike and ledge (move horizontally) instead of making a good retest back down. So, shorting the reaction after a V-spike reversal is a sucker's play. Flags will also fail when there's no volatility.

That's why all these people who develop and sell systems based on directional oscillators like RSI and stochastics...if you test those things out, they're worthless. What they're trying to do is look for a bull or bear flag, which will work in this type of environment but will fail at an extreme volatility high and also in a contracting volatility environment.

There are a million ways to identify a continuation pattern such as a flag. But unless you incorporate a volatility filter into your system, you're not going to have any statistical edge, at least not one I would trade.

It doesn't matter how good a particular pattern seems to be. Even our Short Skirt system, which is based on a short-term continuation pattern that tests out with a 68-percent win-loss ratio on a mechanical basis, is improved by taking volatility into account. If I simply [stop trading the

pattern] after we've had a big move, it will eliminate the system's drawdown periods.

Trend days and range days

After a large up move on the open, the stock market is essentially trading horizontally in the morning, which leads to a debate whether the day will shape up to be a trend day.

continued on p. 72

secutive days of trading from low to high in an individual stock. That would be extremely rare in the S&Ps.

AT: In this case, you were talking about looking for one more move to the upside -

LBR: Normally my directional bias would be to the upside, just based on the momentum analysis. However, I've found the ability to predict a directional bias based on the momentum work

"If I try to guess a breakout, I'm wrong 90 percent of the time.
I'm a perfect contrary indicator."

"In a down-trending market, an early gap up is a short 95 percent of the time."

AT: *More than once you've mentioned "trend days" and "range days." How do you define these?*

LBR: A trend day opens on one end of its range and closes on the opposite end, has range expansion, and makes a steady pattern of higher highs and higher lows, or vice versa, throughout the day. In the index futures, there are two or three trend days a month.

Trend days are typically followed by consolidation days, which are trading-range days during which the market tests back and forth.

AT: *What are signs a trend day may be setting up?*

LBR: Three different types of conditions tend to precede a trend day. First, there's a significant degree of range contraction. You can measure that by simply seeing narrow-range price bars, such as an NR7 day, which is a bar with the narrowest range of the past seven bars. [Trader] Toby Crabel wrote about it in his book.

Second, you can get a trend day after a large opening gap: It could be a large gap down and a trend day up, a large gap up and a trend day down, or a large gap up and a trend day up.

A large gap means one side is caught off balance. When a market comes out of an equilibrium level — such as at these points when there have been inside bars and narrow ranges, or low ADX readings on an hourly chart, or a chart consolidation like a triangle — that's what causes "positive feedback" loops. There's the interaction of people getting stopped out, people initiating new trades — the whole nine yards — so you'll get a stronger move.

Finally, if the market is just approaching new 20-day highs or lows, these points tend to be magnets or key chart levels that will accelerate price action.

AT: *So does today (Nov. 3, 2003) qualify as a trend day?*

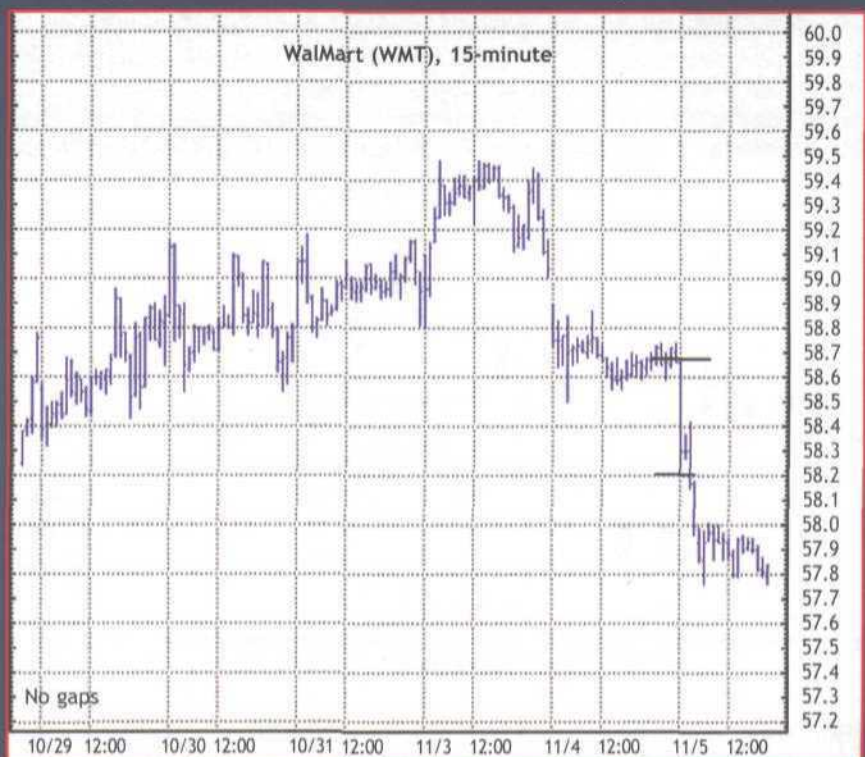
LBR: We have the conditions for a *potential* trend day. To confirm a trend day, you can look for two things. One thing Toby Crabel mentioned was a very large 15-minute bar to open the trading session (see Figure 2, above). Looking at today's first 15-minute bar in the Nasdaq 100, it was not a very large bar, so this would not give us an early jump on identifying a potential trend day. Sometimes the market will open with a big bar down or up, and you know to just go for it.

AT: *How do you quantify a "big bar?"*

LBR: You can determine the threshold of significance yourself,

FIGURE 2 TREND DAY ALERT

One of the things Raschke says indicates the potential for a trend day is an opening 15-minute bar greater than the opening 15-minute bars of the past seven days, an observation she attributes to trader Toby Crabel.



depending on how aggressive you want to be — whether you compare it to the past five opening 15-minute bars or the past 20. You can quantify this type of thing a zillion different ways — you can use a percentage function, or make a comparison relative to the previous n bars, just like a volatility breakout system.

So, we can scan our database and find the stocks that had the largest 15-minute bars relative to the 15-minute bars of the past two weeks. (She pulls up a list of stocks using a program called *Insight*.) There were a lot of Naz shares. If I were trading stocks, this list has the ones I'd want to go with.

Then you can add volume: Which of those stocks have had a significant increase in volume in the first 15 minutes relative to the past two weeks? That's an extremely significant little nugget.

AT: *Does the placement of the close in the preceding bar have any implications for a trending move the next day — if it closed extremely high or low, for example?*

LBR: I don't care that much about a day that closed on its high or low. I'm more interested in how the market behaves after the first 30 minutes of trading. A lot of the pension funds and insti-

"Statistical reliability only comes with a volatility filter."

tutions tend to stand back a little in the first 30 minutes and watch the market settle in to get some confirmation.

The other things we look for in terms of a higher trending day include a volume increase — which we don't have today, but we have to keep in mind today is a Monday, usually a lighter-than-normal volume day.

Then, is there good leadership — are IBM, Microsoft, Intel, GE looking good? Next, I want to see a degree of trendiness between say, 10 and 10:30 or 10:45 a.m. I want to see a steady pattern of higher highs and higher lows after 10 o'clock. If I see that pattern I know it will appear in the afternoon, too.

The last and most important thing is that I want to see trend in the market breadth — the difference between advancing issues and declining issues. (*She pulls up a screen showing the TICK indicator, which is the difference between the number of NYSE stocks trading up on the day minus those trading down on the day.*) Right now you can see breadth is really strong — +1,400. But what you *really* want to see is improvement in breadth from here. You don't want to see the market gap up on strength and see the breadth number deteriorate, or go flat. [If there's no improvement] in volume or breadth, the market is more likely to stay within a trading range. If that's the case, I'll be in more of a scalp mode and just play for small wins — a point or two, or even less.

But if I see volume, trend in the breadth and strong money flows, I'll play for a big target. I'm looking to hold that position until the end of the day, or add to the position during the day, or maybe hold part of it overnight.

Another thing to look for on a trend day is program activity — buy programs on a trend day up. You see that in the TIKI (*the Dow equivalent of the TICK*). Any time these guys fire off the baskets — which they all do now — everything is so highly indexed, it's going to include the Dow stocks, so you'll see the TIKI at +24, +26.

Something I'll almost always do the day after an NR7 day is bracket stops around the early morning range. When I tested this out about five years ago, it didn't matter whether you bracketed the first 45 minutes range or the first hour's range. If there's going to be a trend day, you're going to catch it.

Execution and performance

When discussing her online trading room, Raschke mentions one of her goals is to communicate the importance of the trading process, and the reality of dealing with things such as errors and unexpect-

ed market developments. She talks about missing a trade setup she has been watching develop.

"To me, it's a bigger crime to miss a trade I've been monitoring — I have to put on at least a small position at the market just on principle," she says. "I'd rather try and be wrong than not put the trade on at all. So if I feel like I'm not doing it at an advantageous trade location, I'll reduce the leverage to a minimum, but I'll still make the trade.

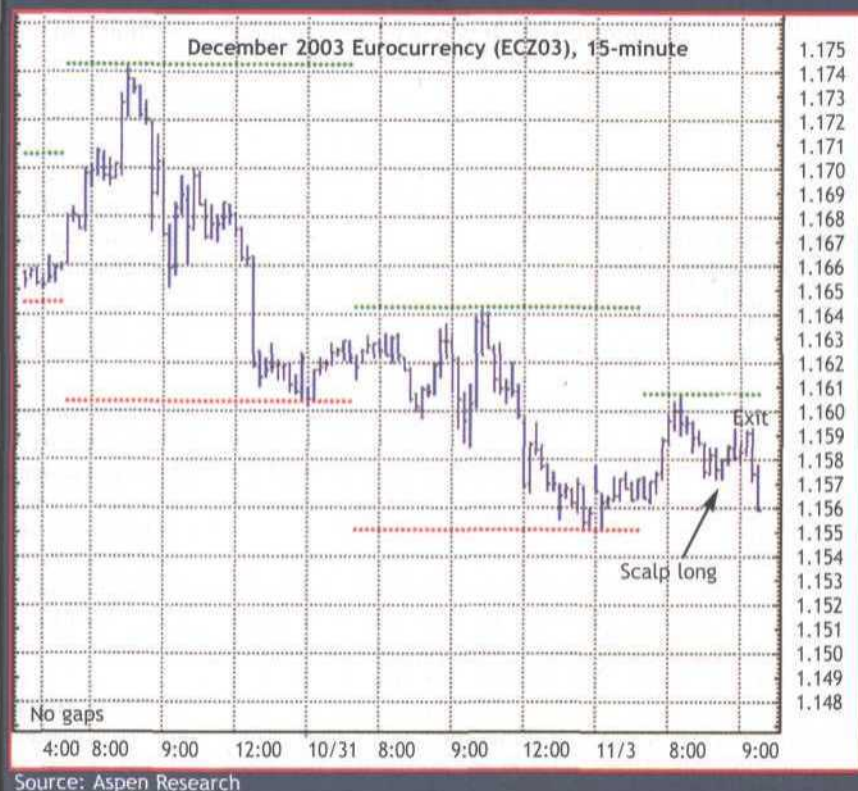
"It hurts my confidence if I don't at least try," she continues. "If you don't follow through, you'll start holding back — like a golfer who won't really swing freely because he's afraid he'll hook or slice. In any performance endeavor, if you start holding back a little bit, it blocks you and messes up your game. You've still got to go for it even if you know the odds of a winner aren't going to be *quite* as high, but it's something you've been watching and monitoring."

In this case, Raschke is referring to a long trade in the December 2003 Eurocurrency (ECZ03) futures that set up in the aftermath of two successful short trades the previous week (see Figure 3, below).

continued on p. 74

FIGURE 3 EARLY MORNING SCALP

The green and red dotted lines mark daily highs and lows, highlighting the fact the market had traded from high to low the previous two days and setting up the potential for a long trade. After exiting an early-morning buy scalp off a higher low on Nov. 3, the market resumed its downtrend.



"As you progress, trading increasingly comes down to limiting unforced errors."

LBR: Now, I've already caught this market moving to the downside two days in row. So this morning I'm thinking, "OK, I like playing the downside because it's rewarding me, but we've already had two down days in a row. Let's see if there's upside potential."

Let's look at what happened here. The market rallied up to the retest — I think it hit 92 or 93 on this little pop - so it could easily turn back down. At the very least, then, I want to pull a stop up to breakeven.

What I'll do is stick an offer out there — always try to make the market take your offer out first, because there's always that edge in selling on the offer and buying on the bid. If it isn't hit within the next two or three minutes, I'll get out at the market.

AT: How do you gauge how much time a trade like that needs?

LBR: The time frame I'm trading on and my objective. Think in terms of how long it takes for an average swing, up or down, to form on a certain time frame. Let's say you're working on a 10-minute time frame. What's the average up swing or down swing going to be — 30 minutes or so? It might be longer, but this gives you an approximate window to work within.

In this case, I wasn't playing for a big target because overall, the market is in a trading range — it's not like I have trends on multiple time frames behind me — and I do know the short-term momentum has been to the downside because the downswings have been larger than the upswings. That's really what I try to do, by the way — I just want to trade in the direction of the most recent greatest swing on my time frame.

And there's some common sense. If you're on a one-minute time frame, you're not going to hold the trade for an hour.

AT: You've said in the past you usually enter a position all at once. Is that still true?

LBR: If I'm trading on a longer time frame, I might put part of the position on initially and then work a bid to see if I can get a better average price. Or, I'll work a bid on half the position but have a buy stop higher in case I don't get filled on the limit order so I don't miss out. In other words, I'll bracket an entry.

AT: Earlier, we were looking over your notebooks of market tendencies, patterns and test results. You mentioned the challenges of using mechanical trading systems, but you still seem to have a systematic bias - you reference different statistics regarding the probabilities of this or that pattern. But ultimately, what you actually do in the market appears to be discretionary.

LBR: Everything I do is discretionary, and I'll be the first to admit that with experience you just get to be a better tape reader. But you still have to start with a framework or structure. You see people who get frustrated after trading only three or four months (*she pauses and shrugs*)...It's like anything. If you're a radiologist and you read x-rays for five years, you're going to develop a better feel for things than if you'd only done it for three months. That's why every doctor has to do an

internship or residency for two or three years.

People don't realize it's the same thing in the markets. Even if you're trading 100-percent mechanically, there are so many nuances to execution and organization, and so many things in the market that can go wrong. How do you handle adverse gaps, and gaps through your stops, for example?

Experience counts for a lot in this business. It's a survival game. If you can persevere and endure for that first two or three years, then you're there. If you do it for a year and get frustrated and quit because you're not profitable — well, that happens to a lot of people.

If you don't know the rules of the game, you don't know what to look for. My former husband used to be a baseball player, and when we'd watch a game he'd say things like, "He's going to throw the ball low and inside, and here's why..." and sure enough, the pitcher would do it. In the market, if you know what to watch for, it makes a world of difference.

Another example is my sport, dressage, which I've been doing for 16 years. It's sort of the equivalent of gymnastics with horses. You try to build up strength, flexibility and suppleness. It can take a long time — six years — to train a horse up to a higher, competitive level, and even longer for the individual rider. I still feel like an amateur in many aspects because for 16 years I've tried to ride a perfect circle with the proper bend in the horse. So I can sympathize with people who are newer to trading.

To the untrained eye watching a horse prance around looks cool, but there's no way to tell a good horse from a bad horse. But after you've watched it a while, you can see how a certain horse holds himself — he's relaxed, his moves are rhythmic, his tail isn't swishing, his ears are perked forward, which means he's happy and listening to his rider. When you can appreciate all the nuances, you can enjoy watching the sport because you know what to look for.

It's like that with the market. I know what to look for, I have my own road map and I know how to read it, which is another important point: It's not like there's a right or wrong way as long as what you are doing translates down to the bottom line! Some people like to look at trading in the context of Elliott Wave, or cycles or something else.

AT: But from your experience, don't you think there are some things that are completely irrelevant or erroneous as far as trading approaches or ideas go?

LBR: If a trader is consistently profitable using a particular methodology, that's what's important. If an approach is not valid or is based upon erroneous assumptions — or even more importantly, it is simply not executable on a real-time basis - then it's worthless because it will not translate down to the bottom line.

Analysis and preparation

Raschke spends a great deal of time each evening analyzing the markets and putting together a game plan for the following

day (which she posts on her Web site). Among other things, she logs the closing prices and two-period ROC for each market, notes any significant volatility conditions, and records market internals such as breadth oscillators and put-call ratios. When reviewing her nightly regimen, she re-emphasizes the importance of using filters and putting information in context.

AT: What do you do after the close or in the morning to prepare for the upcoming trading session?

LBR: The two most important things to look at when you do your analysis at night, or when looking at a system, chart pattern or indicator, is to put it in a context.

First, consider the volatility condition. For example, if a market has already made an exceptionally large move and has entered into a consolidation — has started forming a trading range — you would use certain strategies and trade management.

Or, if the market just formed a long consolidation and just made its first breakout, there might be more runaway-type moves, which will mean looking for different kinds of patterns and entry techniques.

The second context is the higher time frame. I put more emphasis on multiple time frames than I did 10 or 15 years ago. By consulting multiple time frames you know you'll either be trading with the trend or taking advantage of a dominant technical pattern such as a key test.

I might be making my trades based on a daily chart for stocks. If I'm looking at the daily chart I'm always going to put it into the context of the weekly technical structure: Are there weekly sell divergences I need to be aware of? Or is there a broader weekly bull flag forming?

Likewise, in the S&P futures, if I'm looking at a one- or five-minute chart, I want to know if the market is already at the end of a run and perhaps needs to consolidate on a longer time frame. Are we in the middle of an overall trading range? Or did we just break out and make new momentum highs on the five-minute chart for the first time, in which case I can be a little more aggressive?

AT: What are you trying to figure out in terms of your after-hours analysis? What do you want to determine for the next day's trading?

LBR: You need to concentrate on having one trend for the day. For example, say I'm looking to short natural gas because it had such and such a setup, therefore I'm expecting it to trade from high to low, or close lower than it opened. If someone gave you just that one piece of information about a market every day, think how much easier it would be to trade. You wouldn't have to worry so much about your initial trade location, for example.

I think people get too caught up in looking at one-minute or five-minute charts. The majority of the time markets like beans, gold or natural gas are going to trend off their opening prices — more so than the S&Ps, which have more trading range days.

I don't want to understate the importance of the short time

frames there, because the S&Ps futures have more range and volatility, and you can trade them on such a short time frame. But you have to think about getting the main idea right each day for each market. What's the "play" for the day?

AT: Do you think this kind of approach can give you potentially misleading biases, such as refusing to sell because your analysis indicated today was going to be an up day?

LBR: You can pretty much tell right away if you have the right game plan or not [in a market]. I might find out I don't have the right game plan, so I just don't touch that particular market.

I might set up four to 10 short-term swing trades each night, and maybe half of those will fall perfectly into our laps. Others we'll miss, but we almost always make one to three trades a day in another [futures] market, in addition to different stocks.

Parting thoughts

The sun has set before we leave the trading room. Raschke offers suggestions as to what traders can do to get and keep themselves on a profitable track.

"You have to add things, explore everything and find what works for you," she says. "Start out by doing one thing and one thing only — trading a bull flag, for example — and do it well. Then add a simple filter, such as looking at a higher time frame."

That advice might frustrate some. Less-experienced traders often crave hand-holding more than anything, but self-reliance is at the heart of trading progress. The next bit of advice may even be harder for some people to swallow.

"Forget about making money, just get proficient at execution," she says. "Because when you start, you can be nervous and you can freeze up. And with practice, the emotions that accompany trading subside."

She also warns against getting spread too thin or distracted by markets or situations with less potential.

"After you strip everything away, how do you maximize your efficiency?" she asks. "You have only one pair of eyes, no matter how many screens you have. You can only manage so many positions, so go where the volatility and volume are. Spend your time, money and resources in markets where you can ultimately move size. You need liquidity. Once you're consistent, the goal should be to increase your size."

It's almost five hours after the close when Raschke wraps things up, but she still has to put in time later to create the game plan sheet for tomorrow.

As I gather my things, she talks about how important the mental game of trading is, and what she refers to as "rituals" — the various exercises and disciplines she practices every day to maintain her confidence and equilibrium and keep her on track in the markets.

"After 20 years, I still brainwash myself."

Next month: More on Raschke's indicators and trading strategies and techniques.