June 13, 2014

Notes from a Swing Trader
Extract from a 1993 lecture
by Linda Bradford Raschke

(Appendix D - Professional Trading Techniques)

Money (and Risk) Management
Scale in and scale out of trades. That's one aspect of money management on which I concentrate.
I'm always scaling out of trades.
Put yourself in a win/win situation. Take some money off the board; take partial profits. That way you can't lose.
If it then goes against you, at least you locked in something.
If it goes your way, you still have bullets to play with. Don't get greedy.

Most floor traders tend to make money twenty days of the month.
Then in the last two days they get blown out of the water on a big trend day during which other traders are buying breakouts and cleaning up.
When swing trading, you truly don't want to fight a trend day – the market is going to tell you quickly if your play is right or wrong. And if you're wrong, don't fight it.
Always go in with a game plan.
Anytime market action deviates from my road map, I'm out of there because the market is not doing what I expect it to be doing.
If I don't know what it is doing, why am I in there?
Anytime that you're in a trade and you start to have questions like, "Well, what should I do now? Should I get out now? Should I take profits now? Should I stay in a little longer? Should I add to the position?"
Anytime you have a question like that, you have no business being in that market.
You have lost your edge because you don't have any control or game plan in that market.
So, first, before you start swing trading, realize that you never want to put yourself in a position where you're going to be reacting to that market.
I find the best way to control my risk is to watch my equity curve.
Every day I calculate how much money I made or lost.
I don't care which positions made or lost it or how many winners or losers I had.
When my equity curve starts to dip, I know something is wrong – perhaps I am stressed or getting careless.

Something is always working: "**Don't get married to a position; don't get an opinion on a market**."
If I get an opinion on a specific market, I have to stop trading it.
Finally, when a market closes against me, the odds suggest that it will go even further against me.
So I get out. I can always get back in the next day at a better price.
That's my rule.
I don't view it as taking a loss – I'm just playing for better position! And it works!

"Reading the Tape"
The most important points to me are the previous day's high and low. That's all I care about.
Now some people like to do retracement numbers, some people like to do Fibonacci numbers.
Any number is going to work because it focuses your attention on market action relative to another number.
You can take any number and ask if the market is getting closer to or further away from it.
That's all tape reading really is. Is the price making progress towards or away from that number?
You'll find that intraday cycle tops, cycle bottoms, intraday swings, lows, highs, are **important support and resistance levels**.
Even on five-minute time frames, watch those lows and highs on the swings.
If you're on a weekly chart watch the previous highs, watch the previous lows.
What you're going to do is just focus in on the price action around that point.
It's either going to be a test, with the market finding support and forming a nice double bottom
(a high-percentage trade because you can put in a really tight stop and the market should move in your favour right away),
or else it's going to break through
(if accompanied by volume and activity, there is no support but there probably is going to be a continuation).
Perhaps 90% of my trading tends to be looking at previous lows and previous highs on daily charts.
A lot of people like to look for price divergences using oscillators,
or the Elliot Wave fifth wave – which is either a failure top or a last little hook through.
It's still the same concept – double top, double bottom, and tests.
That's what swing trading really is: Buying retracements, finding out where the market finds support, and getting out.
You just have to define what works for yourself.
There is nothing wrong with one time frame or another, or one style of trading or another.
But build a road map in your head. It teaches you to anticipate, to have a plan, anticipate, watch it setup.

Setting Up "The Swing"
Here is what makes a market.
You have a number of different players and time frames in these markets.
You have institutions, commodity pools and funds, and all that kind of big money.
On the other side are all the locals on the floor.
Half of them make their profits off one tick, just trading the market back and forth.
The other half usually close their positions out by the end of the day anyway.
These guys are just scalping, putting money in their pockets; there are really not that many position traders in the pits.
Because of the activities of all these different market players, a two- to three-day swing pattern sets up.
The big guys can't take advantage of it and the little guys don't care; but it creates a perfect niche from which to make a living.
What happens?
The big players, the commercials, know the fundamentals, which their analysts have priced into the market.
They know where they have to deliver x number of barrels in x number of days – a really long-term game plan. They have really deep pockets.

Those guys are right eventually; they have deeper pockets than anybody. They can sit and buy into one decline after another.
Maybe three months later the thing will turn around and they'll sit on it, and then they will start selling out, selling out, selling out.
When the big guys come in to start accumulating their line, it doesn't mean the price is going to hold there,
merely that at some level they start buying.
The locals standing in the pit see Merrill Lynch working an order to buy 1000.
They know exactly what's going on, where the big guys are, so they'll start coming in and buying a little bit, supporting the market.
All of a sudden the price is holding. Because the price is holding, all the people that shorted it earlier are going to start taking it back.
Well, the price stopped going down, so they better start taking it back, which might cause the price to lift a little bit.
Then it starts to rally a little bit.
It trickles up, then some people feel maybe the price is going to go up, so they start buying.
Just about now, traders looking at charts notice it going up.
However, by the time an outside order gets to the pit, everybody else is buying these "breakouts" and the price is already marked up –
and all of a sudden outside orders are chasing it.
And sure enough, like moths to a light, everybody has already bought?
The locals bought their line, the commercials are only buying at this price down here.
Who's left to buy?
What happens when there is nobody left to buy?
The price stops going up. It doesn't fall down immediately, but the price stops going up.
When pit traders sense that loss of acceleration, when the order flow starts to slow down,
those that bought in the morning when nobody else wanted to buy, who knew that the price held there yesterday – start taking their profits.
That puts a little selling pressure on the market and the guys who see weakness in the market come in and start shorting it.
There are always people buying the market and always people selling it.
There is constant supply and demand.
There is always support and resistance in every time frame, always someone taking profits.
Every long is going to have to take a profit or loss, and every short is going to cover at some point.
It's like a zero sum game! It's a two-sided market.
There's always going to be longs getting trapped and shorts getting squeezed.

The Rhythm of "The Swing"
So I look for a swing low and count that as day one.
Day two is going to be the second day up,
and day three I'm going to sell and go short – short it and look to cover on a pullback the next day.
Then I'm back to day one, looking to buy.

So my rhythm is to "buy," "exit," "sell short," "exit," "buy," "exit".

You find that usually there is not enough of a case to stop and reverse.
I just sell and take profits. I find that to be the highest percentage. I know that I can lock it in, put it in my pocket.
I do 90% of my orders at the market; I want in or I want out, I don't dicker over a tick or two.

Higher Bottoms/Lower Tops
How does the market "test the water?"
Prices decline one day and the locals cover their positions.
The market finds support at some point, even if just a little.
What I want to do is buy the test of that support, which the market usually gives you.
The market makes a **V-bottom** only a minority of the time.
Most of the time it makes a **W-bottom**, or **multiple tests**, sometimes with higher and sometimes with lower bottoms.
Tops are very rarely an inverted V;
rarely does a market go straight up and straight down.
You get a test, or at least a sideways ledge or consolidation.

Don't be too anxious; think about what you want to buy, how much, where.
Have a little patience, see what the market is going to do.
You can make a living just ***buying higher bottoms*** and ***selling lower tops***.

My note... *HL... first and second*
LH... first and second!!!