Linda Bradford-Raschke

Linda Bradford-Raschke — Five Trading Patterns

Linda Raschke began her trading career in 1981 as a floor trader making markets (specialist) in equity options on the floor of the Pacific Coast Stock Exchange. In 1984 she became a member of the Philadelphia Exchange, where she expanded into trading futures. A member of MTA and a registered CTA , Linda currently manages over $30 million. She is President of LBR Group, a firm specializing in execution and commercial hedging. She is also President of LBR Moore Trading Inc., a corporation formed with Steve Moore Research Center in Eugene, Oregon which specializes in market research and systems development, in addition to providing a daily fax service.

Jack Schwager, in his best selling book *The New Market Wizards* states that "Among the characteristics that Linda Bradford Raschke cites as essential to being a good trader are a passion for trading, self-reliance in developing trading ideas and making trading decisions, the willingness to take risk, the ability to correct mistakes immediately (because they are inevitable), and patience, patience, patience."

- **Topic: Five Basic Trading Patterns and their Application to the Markets**

Linda will discuss five choice trading patterns she uses. Based on a logical set of market principles, these five patterns work equally well in equity and commodity markets. Understanding these enduring market setups will provide you with a solid foundation for trading technically. They will simplify analysis for the beginner and give the aggressive trader added confidence. Linda has used these patterns as the core of her intermediate term analysis, however, they will work well on any time frame.

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Five Basic Trading Patterns

Linda Bradford Raschke

Introduction

"Speculation, in its truest sense, calls for anticipation."

Richard D. Wyckoff

The concepts introduced in this workshop are patterns I have been using since 1981 when I originally subscribed to a charting service called Security Market Research. The service plotted a 3-10 simple moving average oscillator with a 16-period moving average of the oscillator, which one was to update nightly. Though I originally traded the patterns on equities, I have since used these tools as the basis for my intermediate analysis on all markets.

Pattern recognition, which is simply the study of recurring patterns, actually includes all forms of technical analysis. Traditional bar chart patterns are a SUBjective form of pattern recognition - they are not easily verified by statistical methods. (Two different technicians might vary their interpretation of a head and shoulders pattern, for example). Oscillators can be considered an OBjective form of pattern recognition. This is because a specific mathematical definition can be given to them and thus they can be tested. It is easier to develop clear and specific trading rules from OBjective analysis. The patterns presented here have been statistically tested and do have an "edge".

It is very difficult to predict what a market will do all the time. A good trader merely takes advantage of recognizable patterns that do occur and stays out of trouble the rest of the time. One only needs a few successful patterns to make a good living. Think about it in terms of specializing in a particular arbitrage. Sometimes people feel more comfortable with one pattern over another. Some people see the same pattern represented by different indicators. One thing is for certain, though, and that is the more attention one can give to studying patterns, the more confidence one will gain in their ability to anticipate and take advantage of them.

Main Principles Behind Patterns

Before I introduce the specific oscillator patterns used to generate trading signals, I want to discuss some market principles that will lend a bit more credibility to these patterns and explain the power behind them. Each principle is related to the other, yet each is represented in a different way.

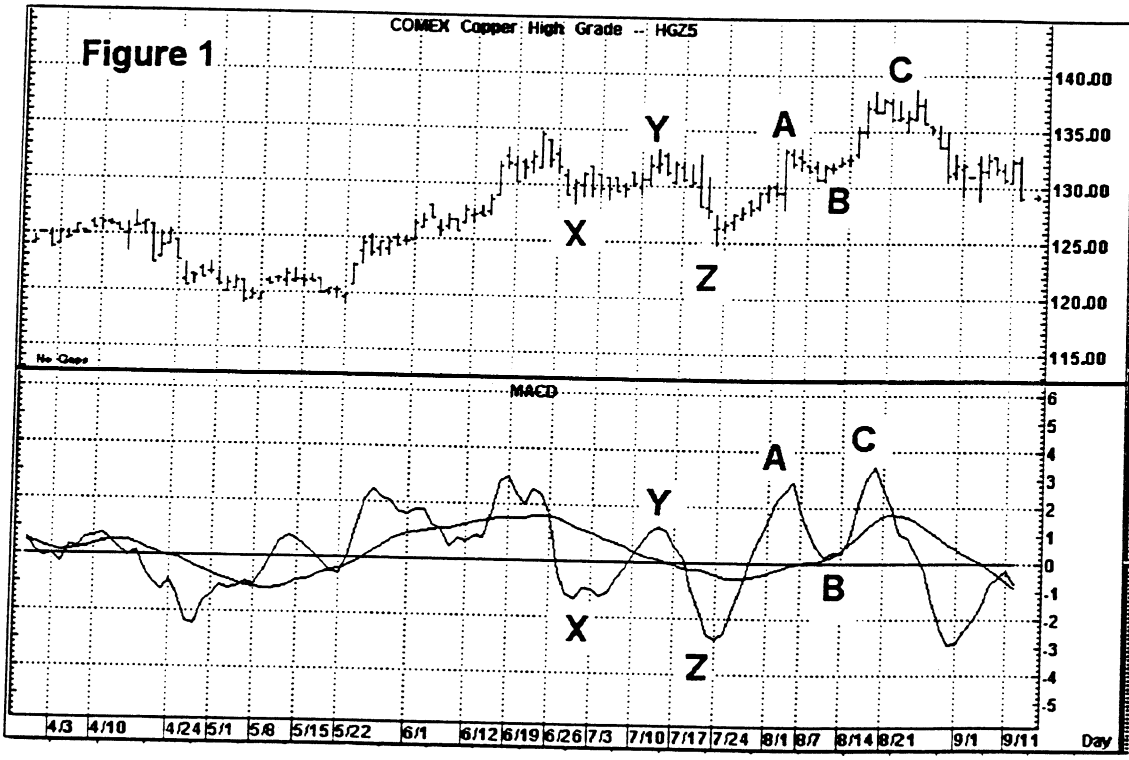
I. Price Pulse or Basic Wave (A-B-C ... X-Y-Z)

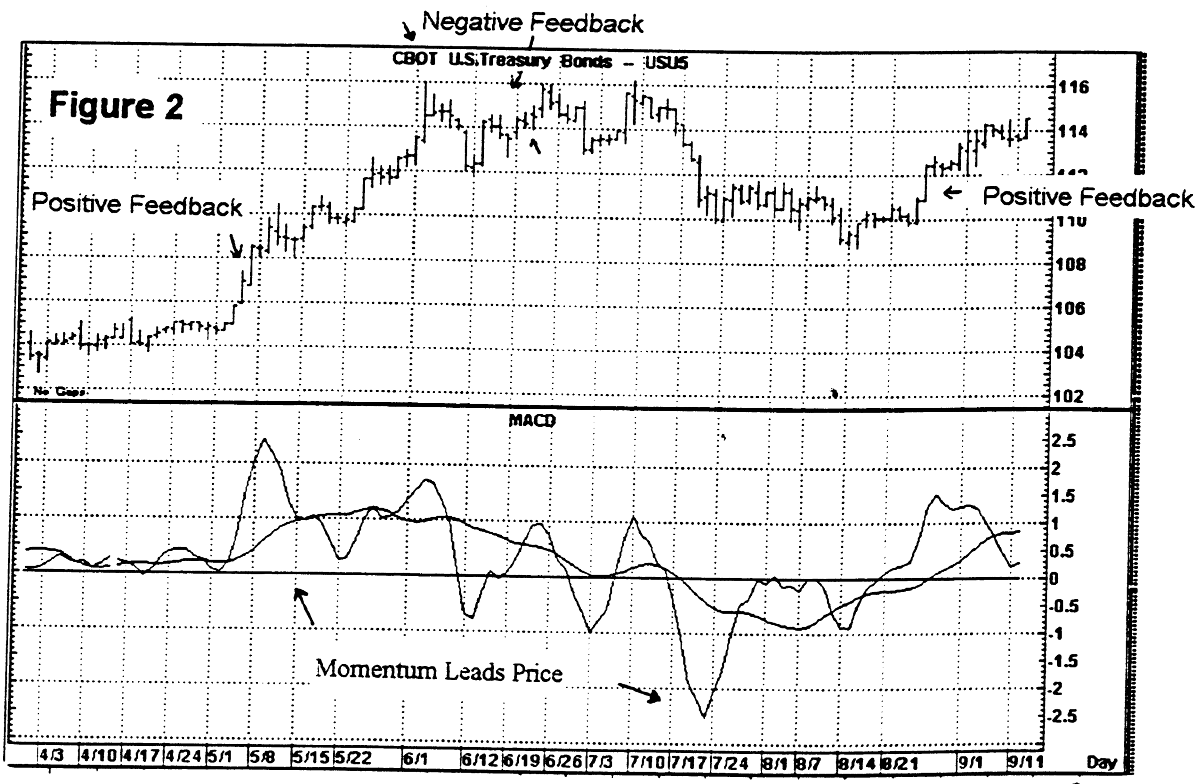
II. Momentum - Leading Indicator Functions

III. Range contraction/expansion
(used for filtering in pattern recognition)

IV. Positive Feedback (Deterministic Chaos)

V. Negative Feedback (Oscillating Systems)





* CHARTS COURTESY OF ASPEN GRAPHICS

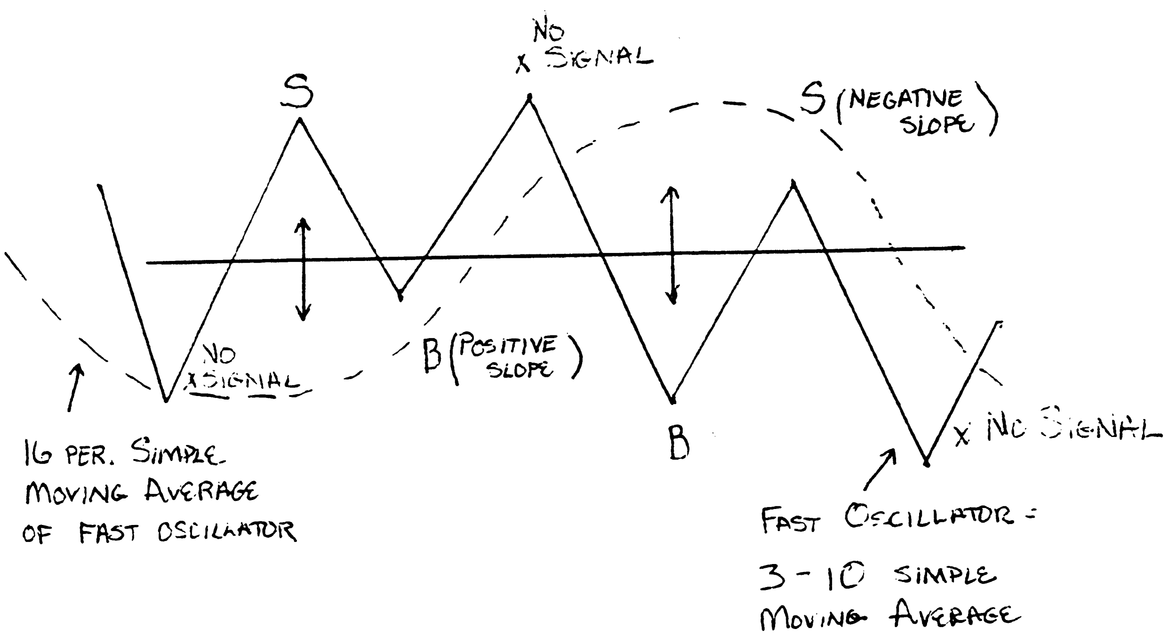
Initial Buy and Sell Setups

For simplicity's sake, we will refer to the 3-10 moving average oscillator as our "fast oscillator" and to the 16-period moving average of the 3-10 as the "stability of trend" line, or the slow line.

Buy pullbacks in the fast oscillator only when the slow line is greater than zero or has a positive slope.

Sell rallies in the fast oscillator only when the slow line is less than zero or has a negative slope.

The only exception to the above rules is the "Divergent-10" pattern or the rarer "2X pattern", both to be described later.



First Cross

Oscillator Pattern: Buy the first pullback in the fast oscillator after the slow line crosses above zero for the first time. (for Buy)

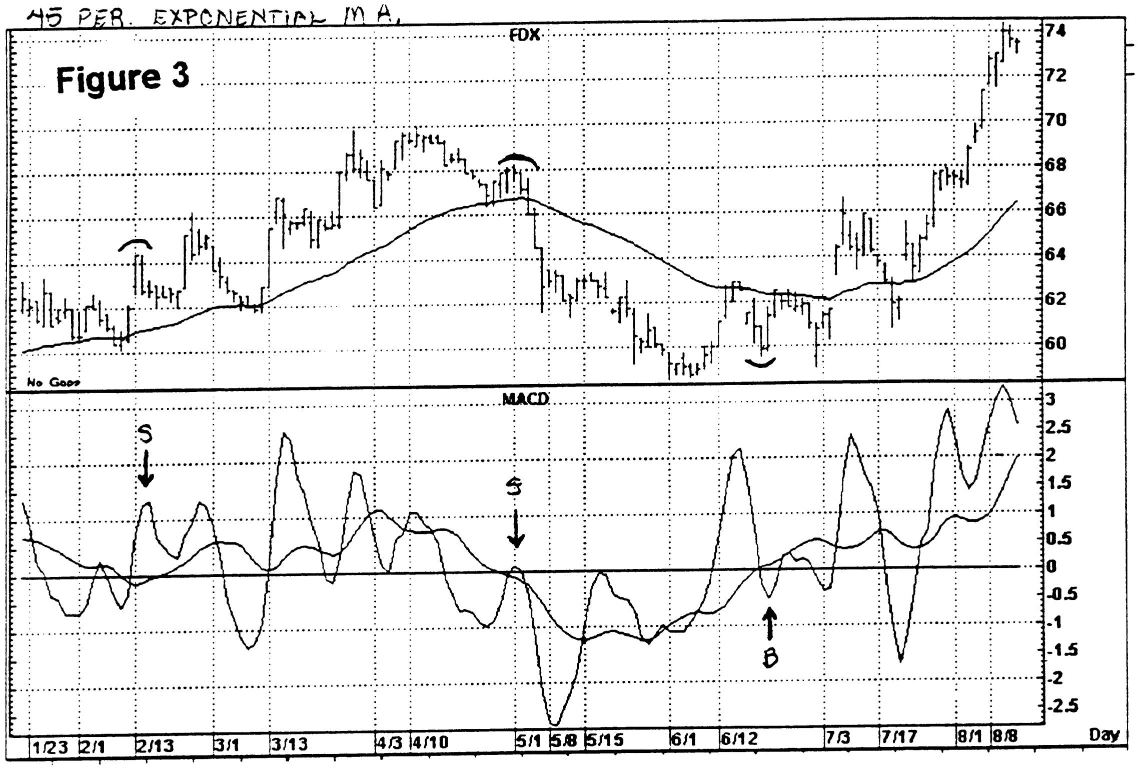
Price Pattern: Usually is first higher low on bar chart(or first lower high).

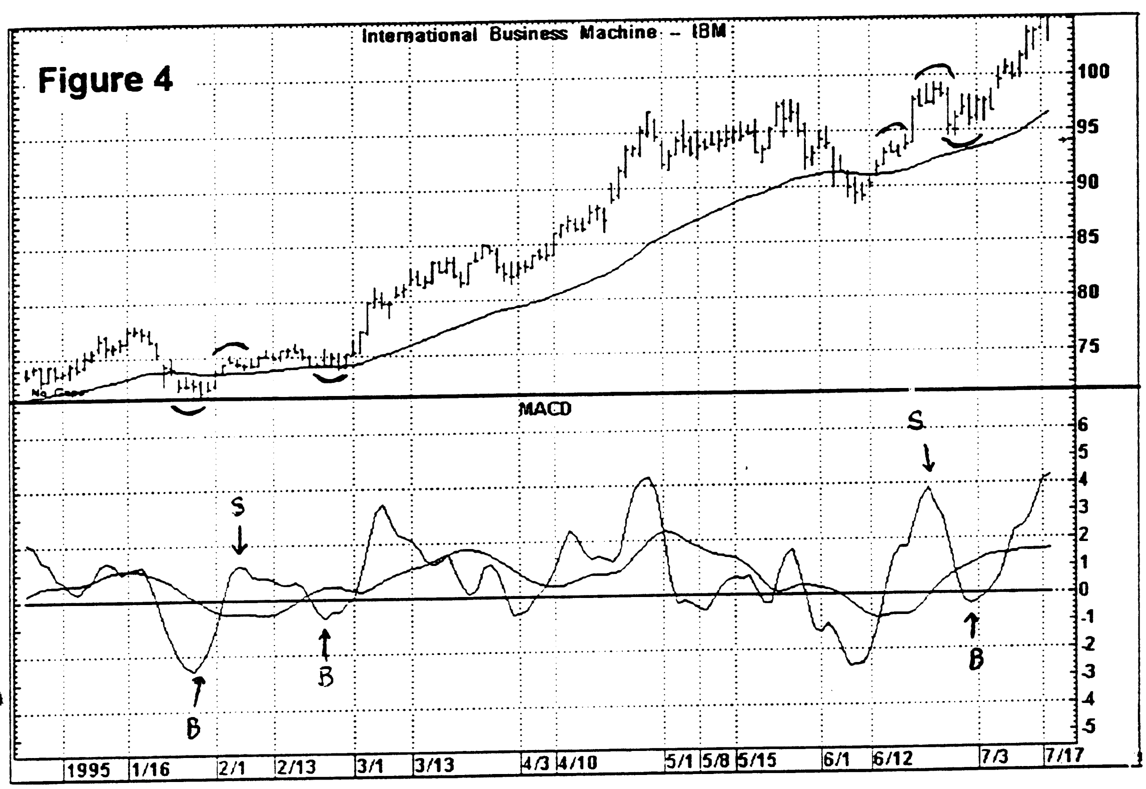
Average holding time: 6 - 10 days.

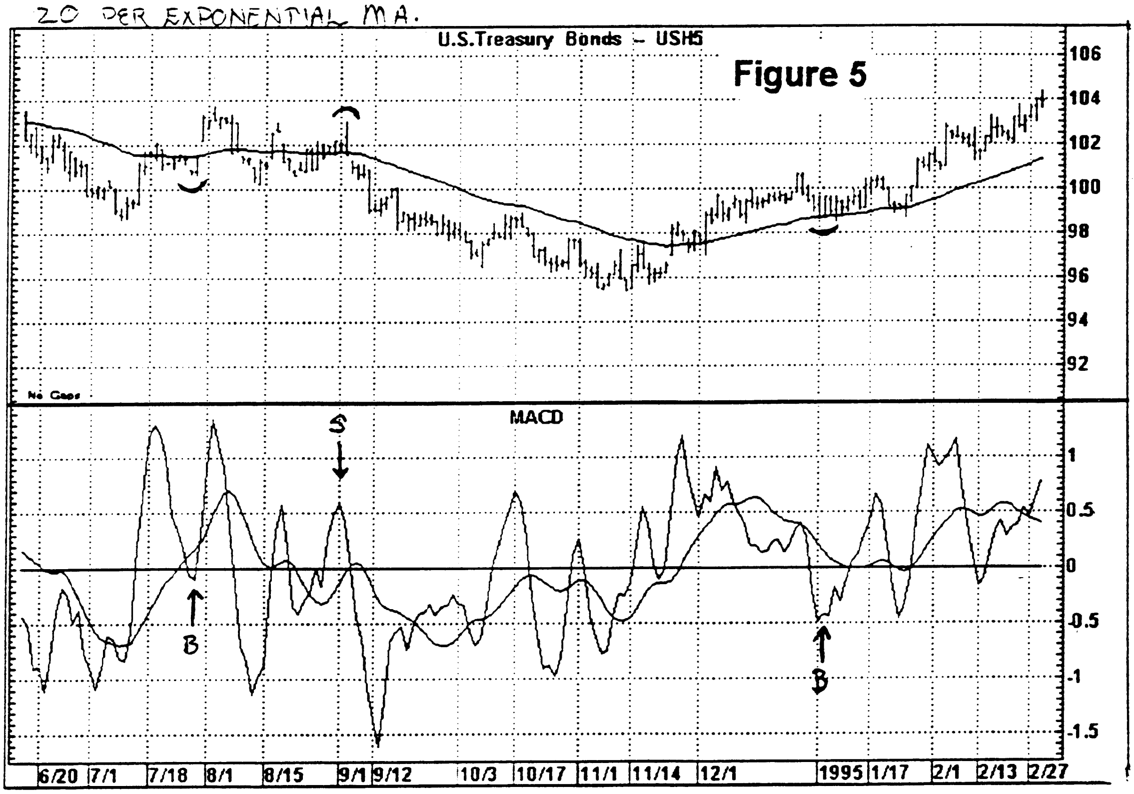
This is the most basic trading strategy. The first pullback tends to be the best. The probabilities fall off on the second and third pullbacks.

One essentially gets "pieces" of the trend and gets out before the trend starts turning. Steady profits are locked in on winning trades at the expense of leaving potentially larger moves on the table. Again, we are playing for the most probable event. Parabolic, runaway moves are the exception, not the rule.

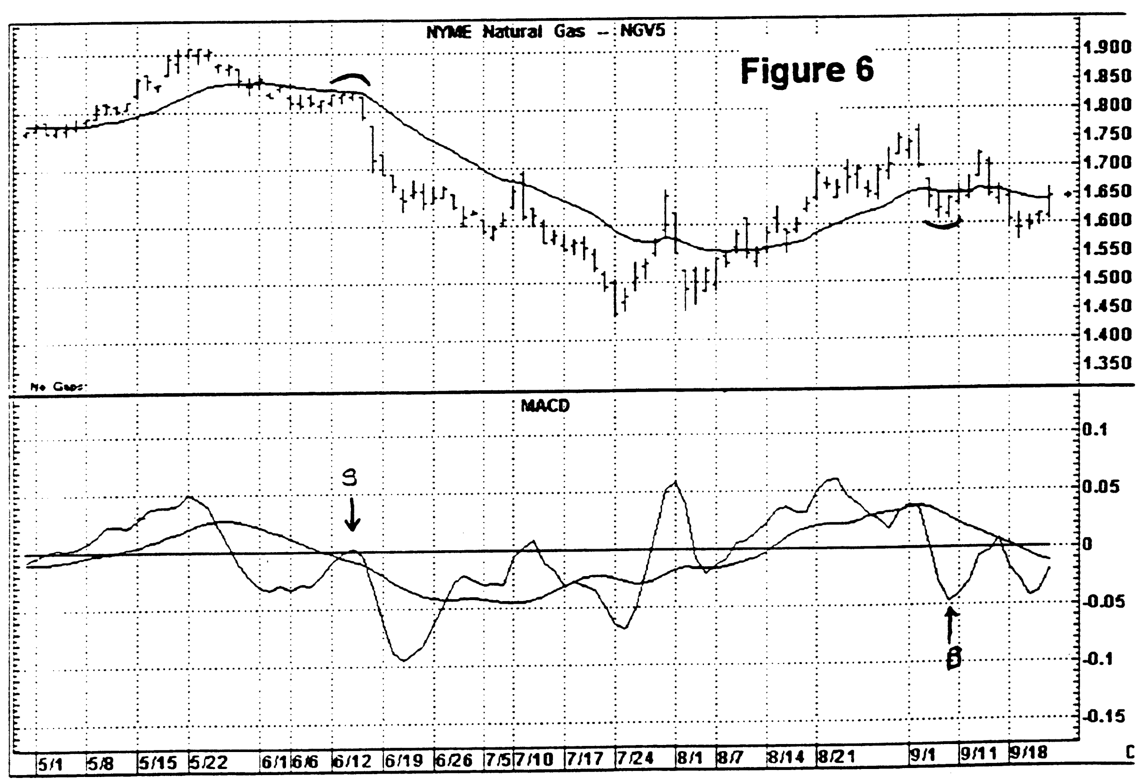
The trend is defined simply by whether the slow line is above or below zero. We are not concerned with the slope of this line which will usually be correcting back to the zero line at the time of entry. Although this pattern sounds quite basic, it can sometimes be tricky to enter as the trades have a very small entry window. You must learn to anticipate this setup and be ready for the trade when it comes. It is usually forgiving of sloppy entries, as the force of the trend should be behind you.


45 PER. EXPONENTIAL M A.
Figure 3
FDX
MACD
S
S
B
No Gaps
74
72
70
68
66
64
62
60
3
2.5
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
1/23
2/1
2/13
3/1
3/13
4/3
4/10
5/1
5/8
5/15
6/1
6/12
7/3
7/17
8/1
8/8
Day


International Business Machine – IBM
Figure 4
MACD
S
S
B
B
B
100
95
90
85
80
75
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
1995
1/16
2/1
2/13
3/1
3/13
4/3
4/10
5/1
5/8
5/15
6/1
6/12
7/3
7/17



20 PER EXPONENTIAL MA.
U.S.Treasury Bonds -- USH5
Figure 5
106
104
102
100
98
96
94
92
No Gaps
MACD
S
B
B
1
0.5
0
-0.5
-1
-1.5
6/20 7/1 7/18 8/1 8/15 9/1 9/12 10/3 10/17 11/1 11/14 12/1 1995 1/17 2/1 2/13 2/27



NYME Natural Gas -- NGV5
Figure 6
1.900
1.850
1.800
1.750
1.700
1.650
1.600
1.550
1.500
1.450
1.400
1.350
No Gaps
MACD
S
B
0.1
0.05
0
-0.05
-0.1
-0.15
5/1 5/8 5/15 5/22 6/1 6/6 6/12 6/19 6/26 7/5 7/10 7/17 7/24 8/1 8/7 8/14 8/21 9/1 9/11 9/18

Sling Buy/Sell

Oscillator pattern: (Buy) - Fast oscillator completes a corrective X-Y-Z wave down. The slow line is still greater than zero.

Price pattern: The chart price low on the "Z" wave is higher than the price low on the "X" wave. (Price usually finds support around the 20-period exponential moving average!)

Average holding time: If the pattern occurs at the end of a long trend, 4-6 days is the average time window. If the pattern occurs at the beginning of a move (2-4 weeks after the 20-period moving average turns up), the average holding time is 6 weeks.

Trigger:

> *Conservative:* Breakout of 2-day high/low...or First day of oscillator turn down.
>
> *Aggressive:* Fade " range expansion" bar (climax) at end of oscillator pulse

Always place a money-management stop just beyond the newly formed swing high/low.

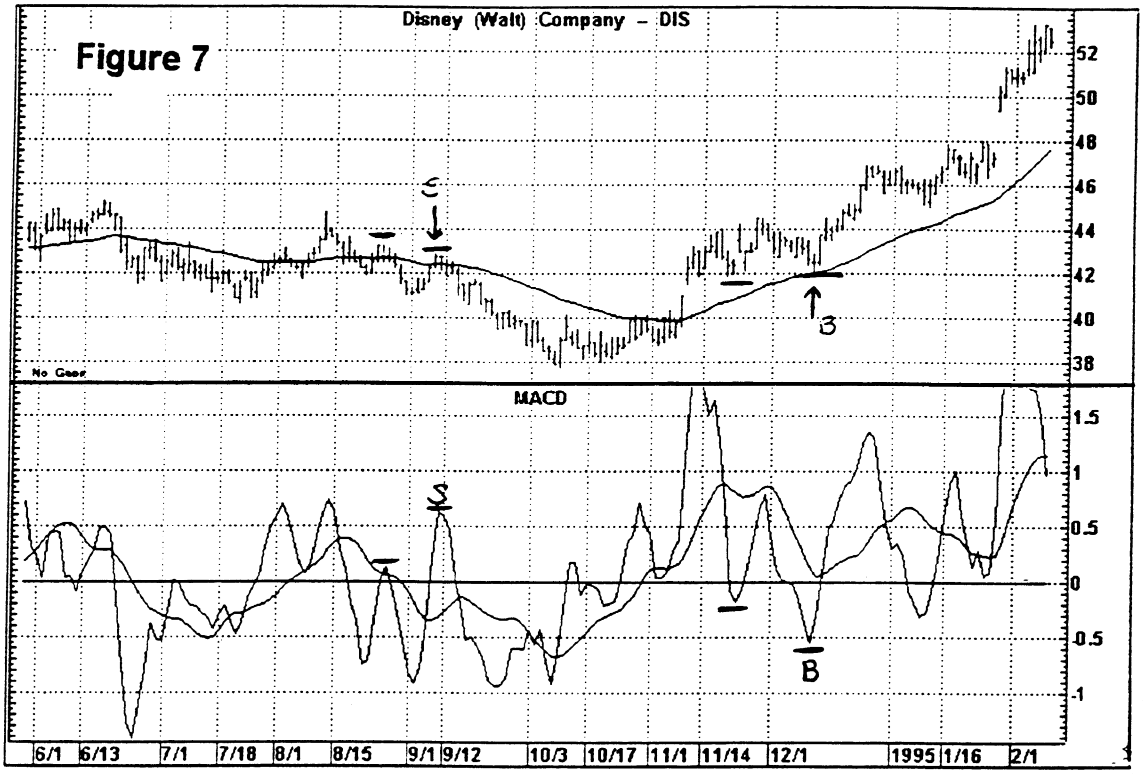


Figure 7
Disney (Walt) Company - DIS
MACD
S
S
B
B
6/1
6/13
7/1
7/18
8/1
8/15
9/1
9/12
10/3
10/17
11/1
11/14
12/1
1995
1/16
2/1

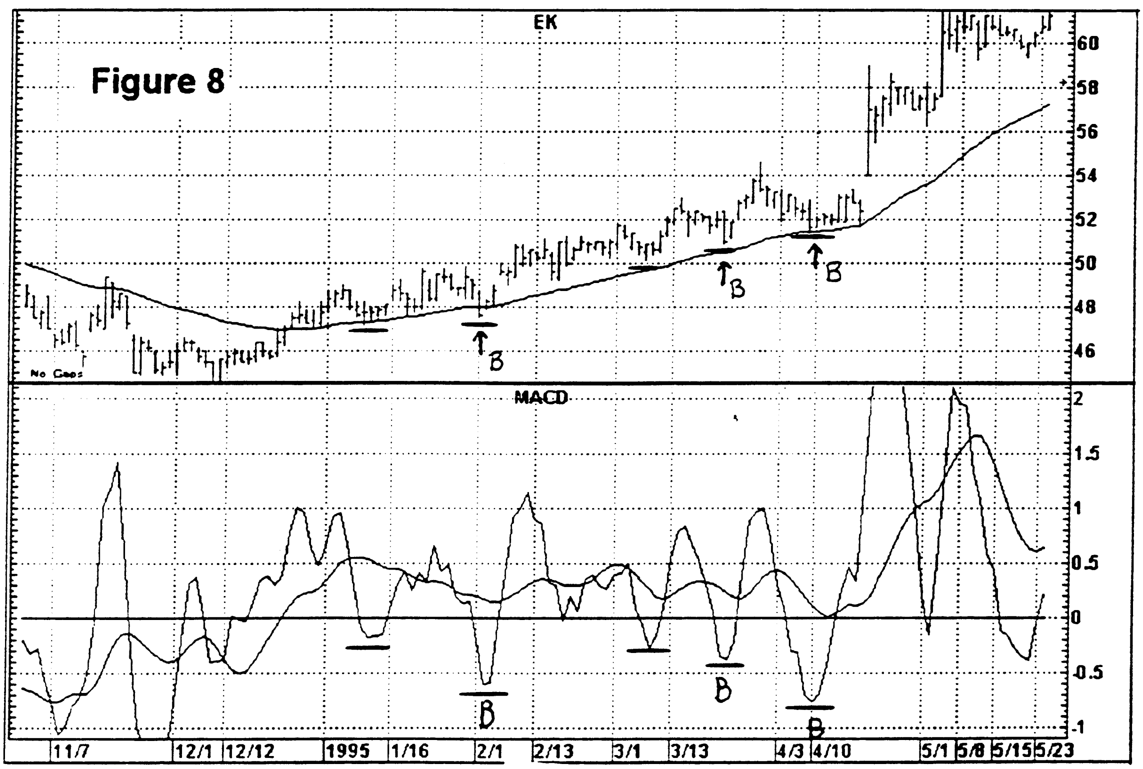
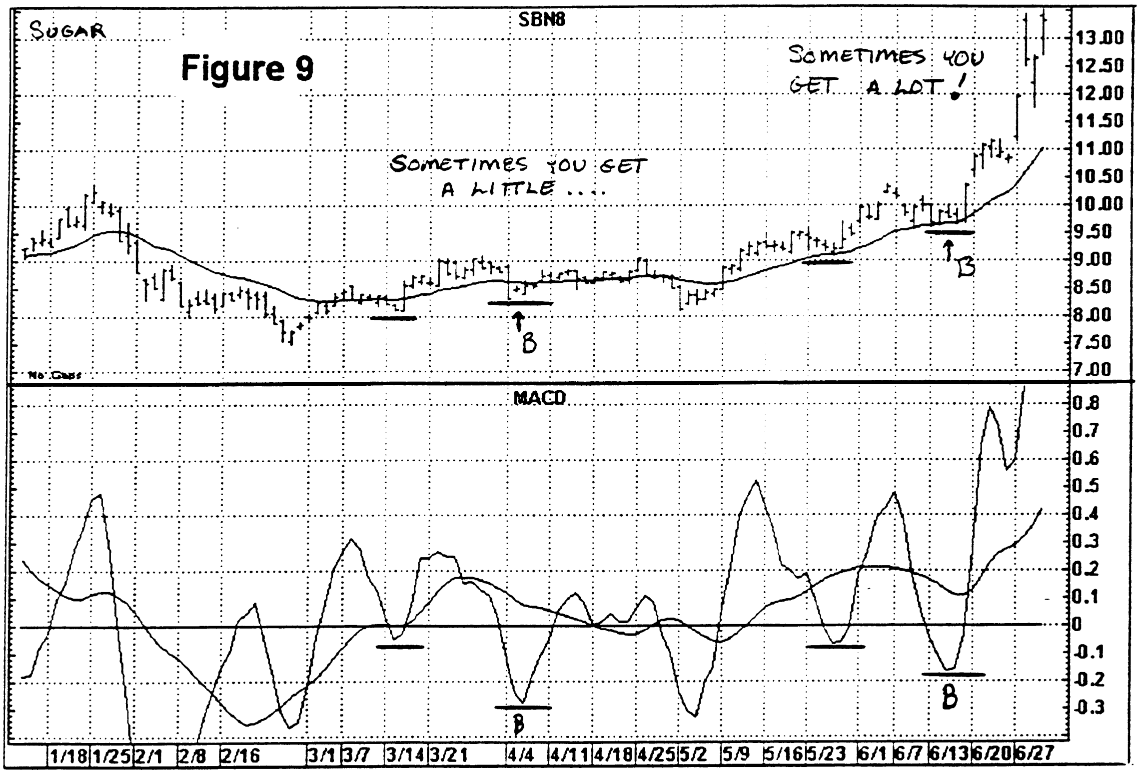
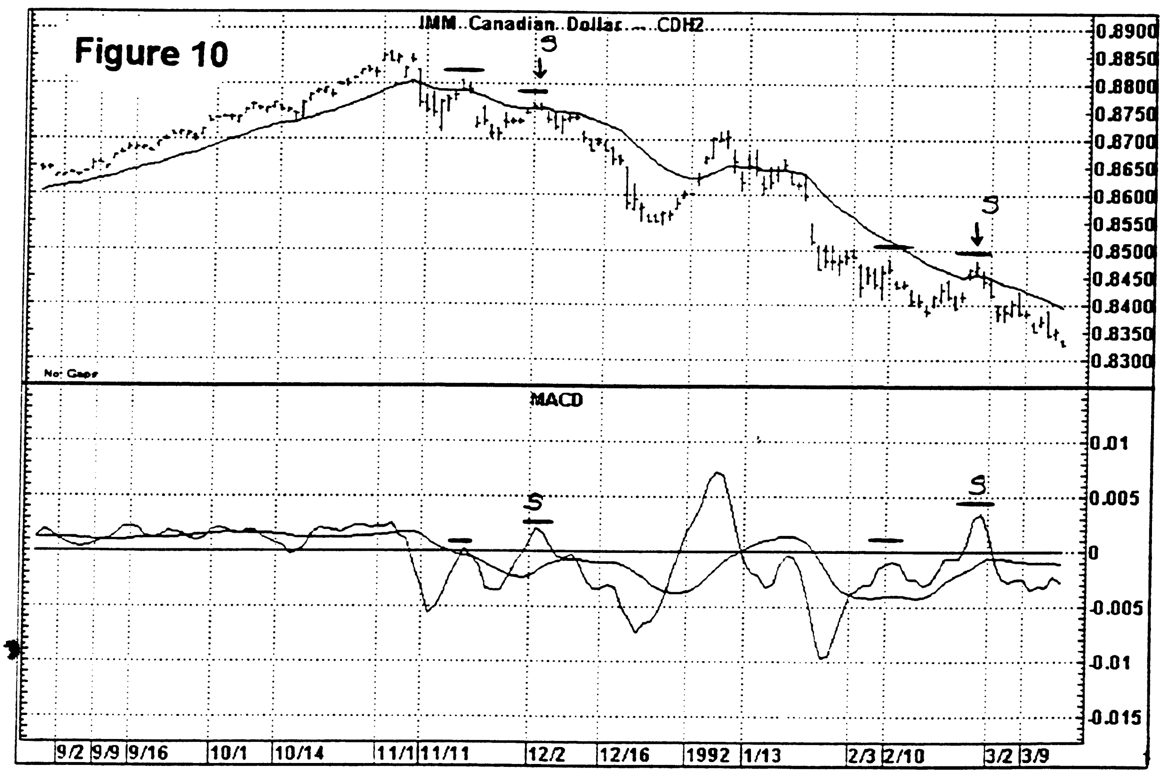


Figure 8
EK
MACD
B
B
B
B
B
B
11/7
12/1
12/12
1995
1/16
2/1
2/13
3/1
3/13
4/3
4/10
5/1
5/8
5/15
5/23



SUGAR
SBN8
Figure 9
SOMETIMES YOU GET A LOT!
SOMETIMES YOU GET A LITTLE....
B
B
MACD
B
B
No Gaps
13.00
12.50
12.00
11.50
11.00
10.50
10.00
9.50
9.00
8.50
8.00
7.50
7.00
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
1/18 1/25 2/1 2/8 2/16 3/1 3/7 3/14 3/21 4/4 4/11 4/18 4/25 5/2 5/9 5/16 5/23 6/1 6/7 6/13 6/20 6/27



IMM Canadian Dollar CDH2
Figure 10
S
S
MACD
S
No Gaps
0.8900
0.8850
0.8800
0.8750
0.8700
0.8650
0.8600
0.8550
0.8500
0.8450
0.8400
0.8350
0.8300
0.01
0.005
0
-0.005
-0.01
-0.015
9/2 9/9 9/16 10/1 10/14 11/1 11/11 12/2 12/16 1992 1/13 2/3 2/10 3/2 3/9

Anti Minor

Oscillator Pattern: The fast oscillator corrects back into a sloping slow line. The first wave of a price pulse is already established.

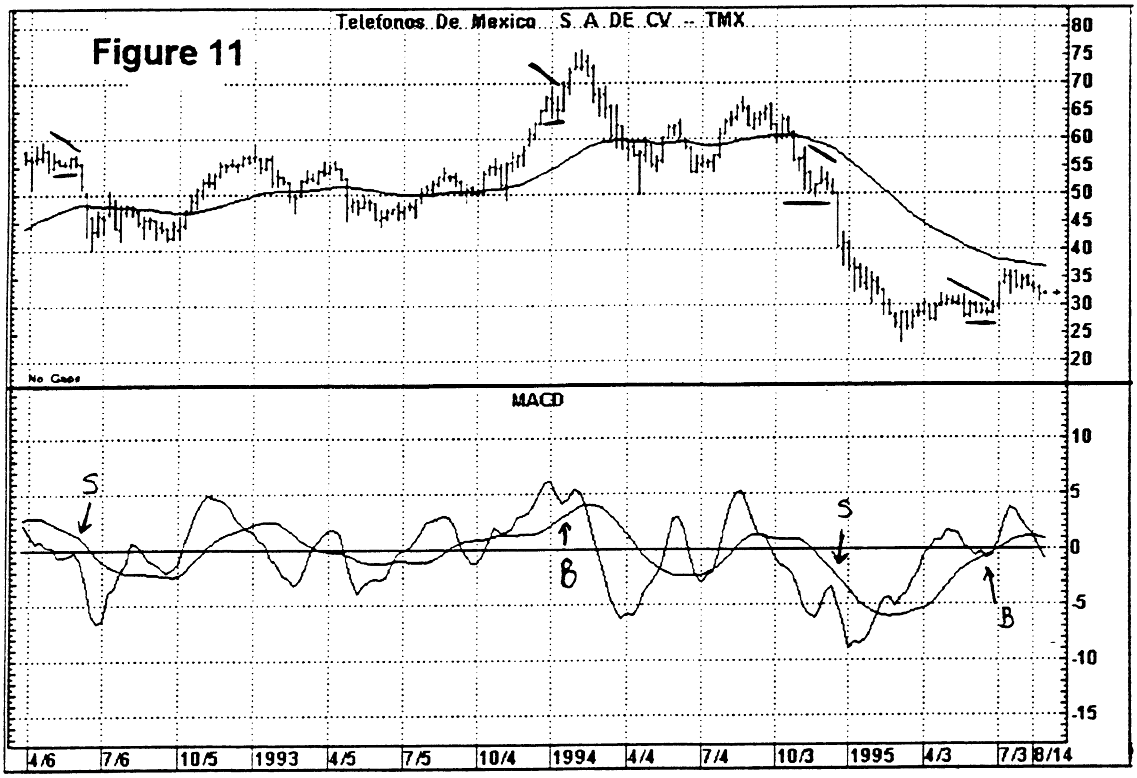
Price Pattern: Small flag, triangle or ledge.(Average 3-4 days in length)

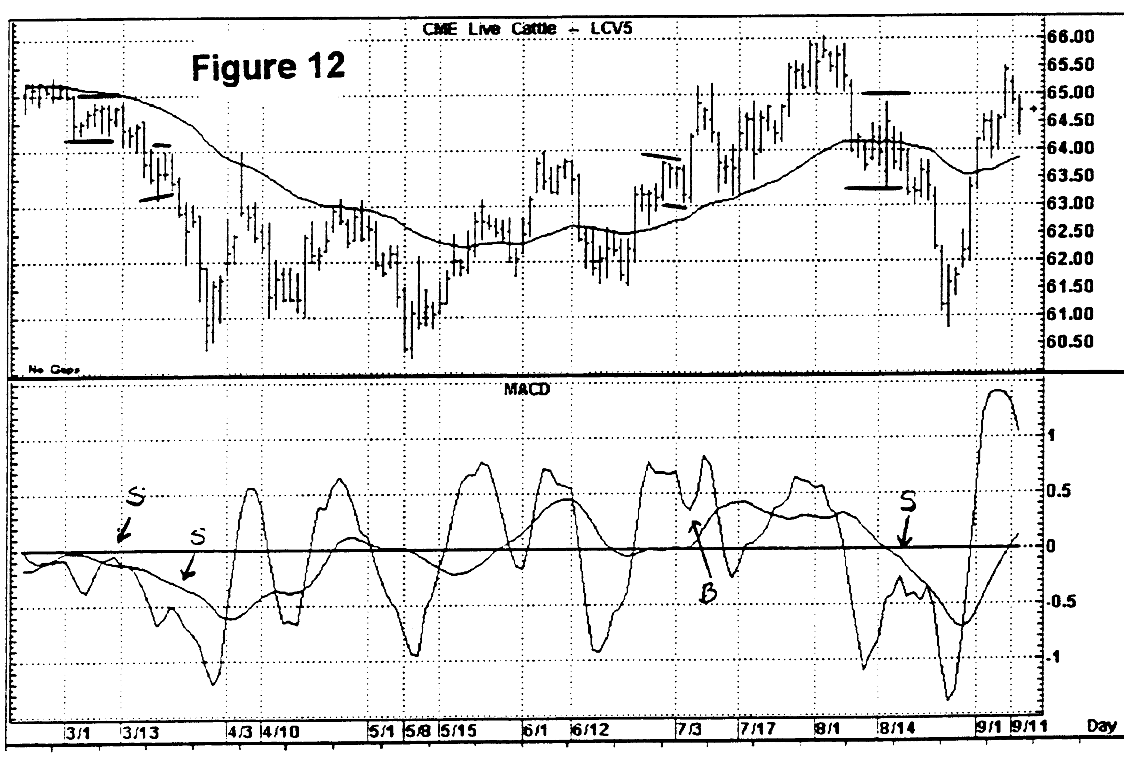
Trigger: Use a stop beyond the previous day's high/low or a trendline breakout across day one and day three.

Average holding time: 4 days!

This is a very high percentage trade which tends to be short and fast. The most obvious patterns occur as the second pulse in an ABC or XYZ wave or against a strongly sloping slow line. Since the second pulse of the wave precedes a reversal, the average holding time is short, but sharp climatic bursts yielding good profits often occur before a reversal, so these are very worthwhile trades to take.

The reason it's called an "anti" is because the fast line is correcting against, or counter to, the slow line. One is always entering in the direction of the intermediate term trend. Thus, it pays to anticipate this set up and enter on a breakout trigger. This is because short term positive feedback kicks in and can create a strong trend day.


Telefonos De Mexico S A DE CV -- TMX
Figure 11
80
75
70
65
60
55
50
45
40
35
30
25
20
No Gaps
MACD
10
5
0
-5
-10
-15
S
B
S
B
4/6
7/6
10/5
1993
4/5
7/5
10/4
1994
4/4
7/4
10/3
1995
4/3
7/3
8/14


CME Live Cattle -- LCV5
Figure 12
66.00
65.50
65.00
64.50
64.00
63.50
63.00
62.50
62.00
61.50
61.00
60.50
No Gaps
MACD
1
0.5
0
-0.5
-1
S
S
B
S
3/1
3/13
4/3
4/10
5/1
5/8
5/15
6/1
6/12
7/3
7/17
8/1
8/14
9/1
9/11
Day

Divergent Buy/Sell

Oscillator Pattern: A higher low (or lower high) from a momentum peak followed by a move which reverses both the solid and the slow line.

Price Pattern: Rising Wedges, descending triangles. Intermediate term double bottoms or tops.

Set Up: A price test which falls 8 to 12 days from a swing high/low (Usually falls exactly 10 days later!)

Trigger:

Conservative: Breakout method off range contraction, or 1st lower close(sell) or higher close(buy) within time window.

Aggressive: Fade move into time window on buying/selling climax

Divergences are wonderful patterns to use with options. The resulting move out of this pattern should be sharp and swift so the added leverage is nice. This patterns sets up against the trend and that is a factor which should be respected. Sometimes a divergence will reverse an intermediate trend. However, if the market has <u>not</u> moved sharply away from your entry price after three days, close out the trade, as the underlying trend will probably resume.

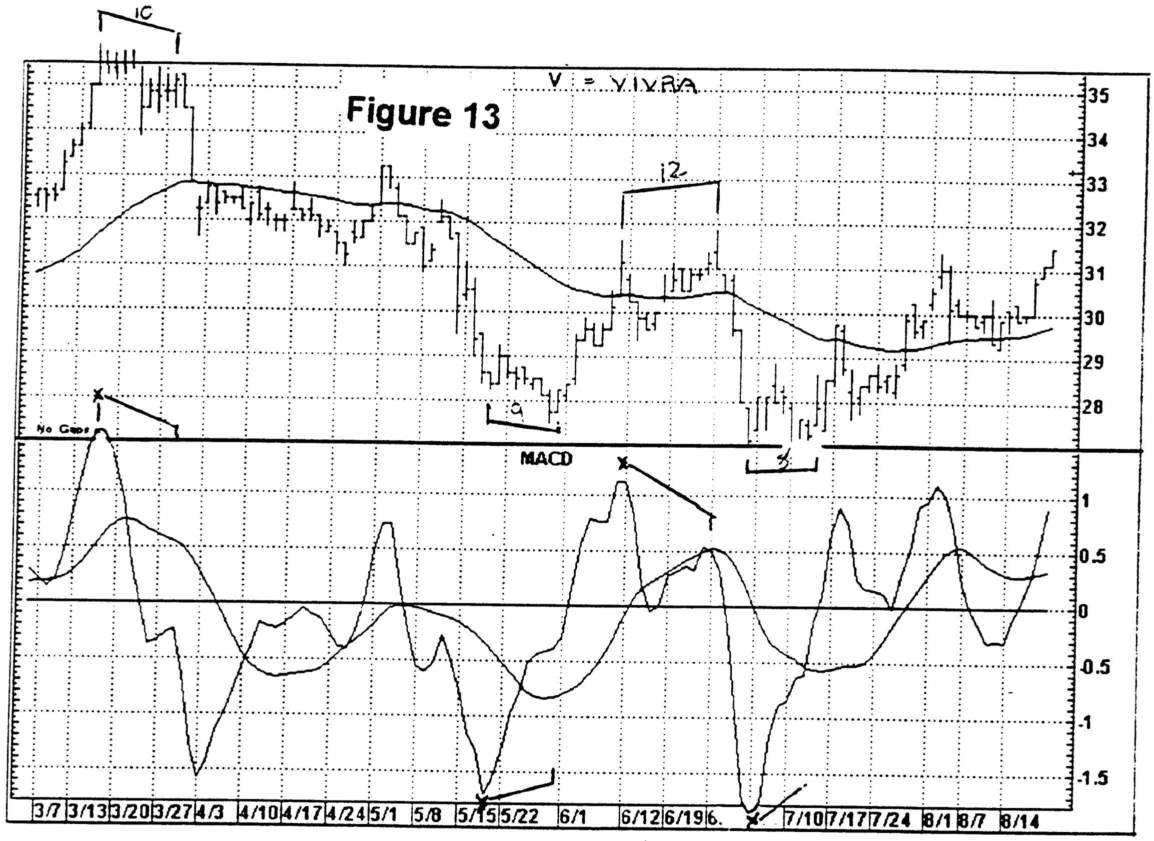


Figure 13
V = VIXRA
MACD
No Gaps

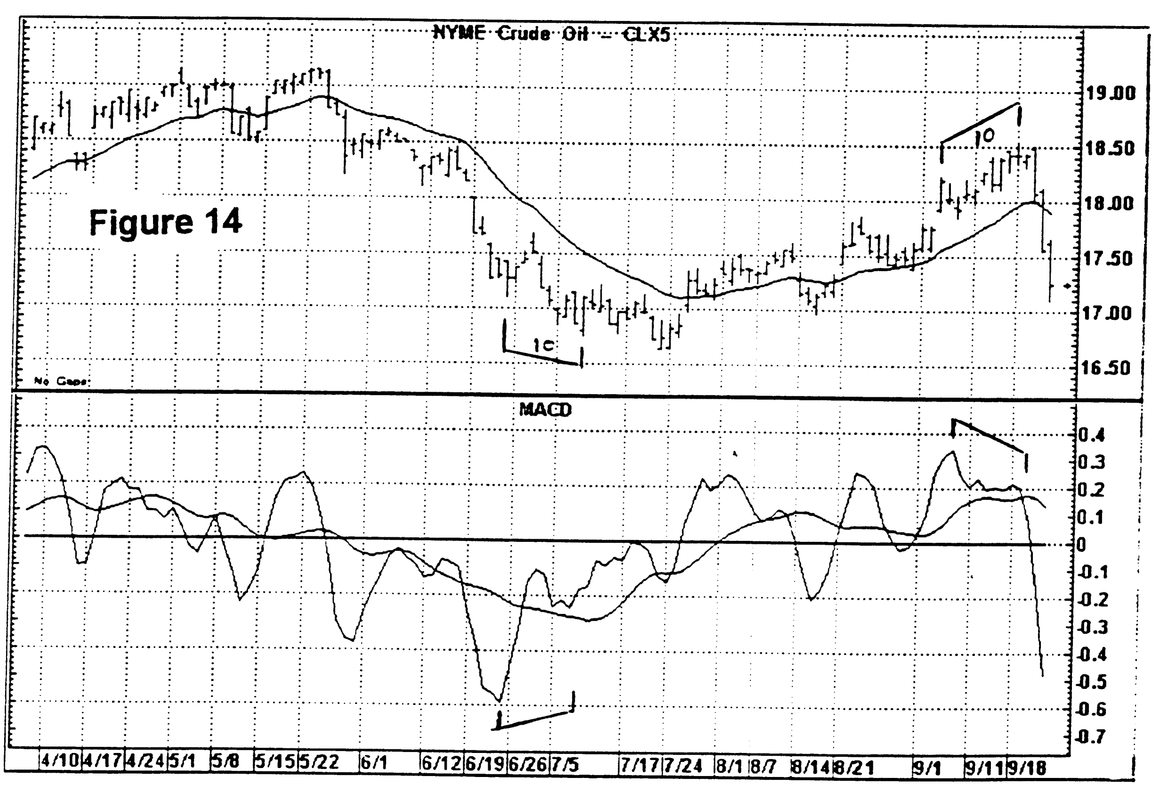


Figure 14
NYME Crude Oil — CLX5
MACD
No Gaps

Double Tops/Bottoms(2X)

Oscillator Pattern: The slow line makes a move through the zero line after staying positive or negative for a period of time. The fast oscillator then makes a peak 4-5 weeks from a previous oscillator peak. This ultimately forms a divergence in the slow line which is needed to reverse a strong trend. (A frequent pattern for the fast oscillator is a Pulse followed by a single oscillator hook.)

Price Pattern: Major Double Top or Bottom approximately 4 to 5 weeks apart which can be a significant trend reversal.

Trigger: Enter on opening of first day after fast oscillator reversal.

Average holding time: 4 - 12 weeks

This is an amazingly common pattern for major trend reversal. It ends strong trends which often run a couple months in duration. Obviously, it doesn't occur that often, as a major trend reversal might only occur once or twice a year, but it occurs in every single market, including equities. Its value is twofold. Anticipating it keeps one from prematurely bottom fishing or top picking. It then allows one to anticipate a long term trading strategy.

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Range Expansion As A Climax Exit Point

Market momentum - The market either uses it or loses it! Market moves end when there's a range expansion climax or a contraction indicating that the momentum is spent. Both are indications that there are no more buyers left (or sellers).

If the market loses momentum with a range contraction at the end of the swing, one would think that a large range day would signal continuation or increased momentum. However, this does not test out. The only time this holds true is at the beginning of a swing - i.e., the first or second day after a reversal. All other cases tend to be buying or selling climaxes. The market has used up all its bullets! (The exception to this is in the late stages of a runaway market, but this is an infrequent occurrence).

Let the market tell you when it's through going up or down. *"When the ducks quack, feed them"*.

I like to trade two units. Take conservative profits on one unit and push the other unit. Put yourself in a Win/Win position. Psychology is a very important part of trading.

Figure 17

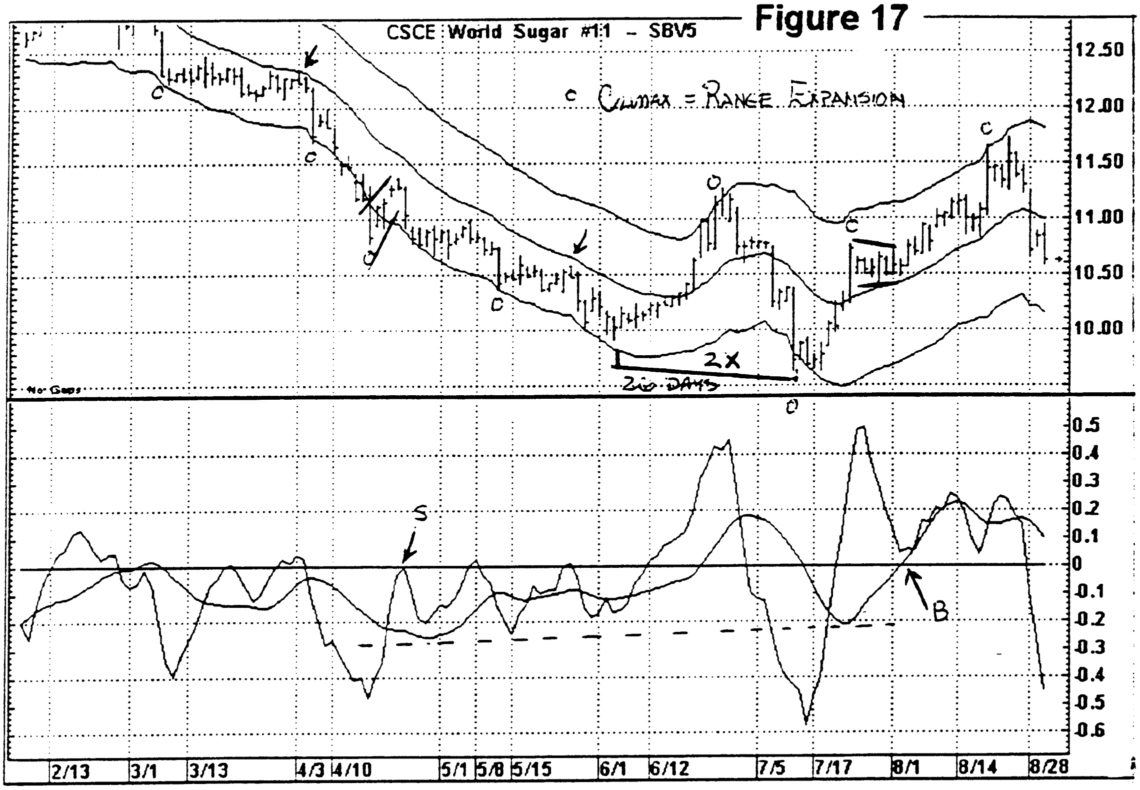
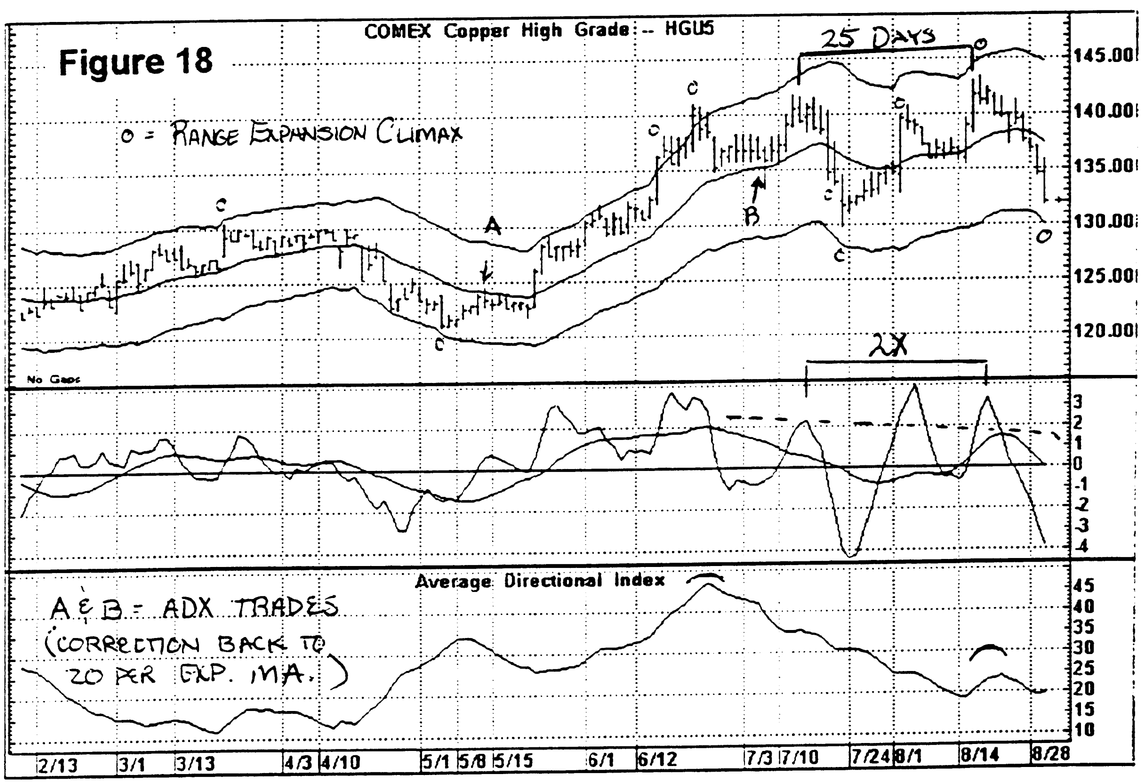


Figure 18



A Note on Trade Objectives

There are two types of trading objectives: Time limits and price limits. Time limits give an optimal window to allow the market to work in our favor. We take what the market gives us and on average this will generate a positive expectation. Some patterns have no predictive value beyond three to four days, whereas others have very strong long term implications.

There are only three types of price objectives I practice:

1) Moves to previous highs/lows

2) Moves back to a moving average

3) Equal length swings

If I mentally set a price objective, it is to keep my patience and allow time for the trade to work. I never expect these price limits to contain a move or to even be met in the first place. They are only reference points to monitor how strong or weak a market's action is.

In a trending market, there are no limiting objectives in the direction of the trend. Professionals do not set price targets in trends. Positive feedback loops can carry a market to unexpected extremes.

For anyone who has a mistaken fascination with measuring methods, I highly recommend "Techniques of a Professional Commodity Chart Analyst", by Arthur Sklarew. He concisely lists fifteen interesting methods in approximately twenty pages.

Figure 19

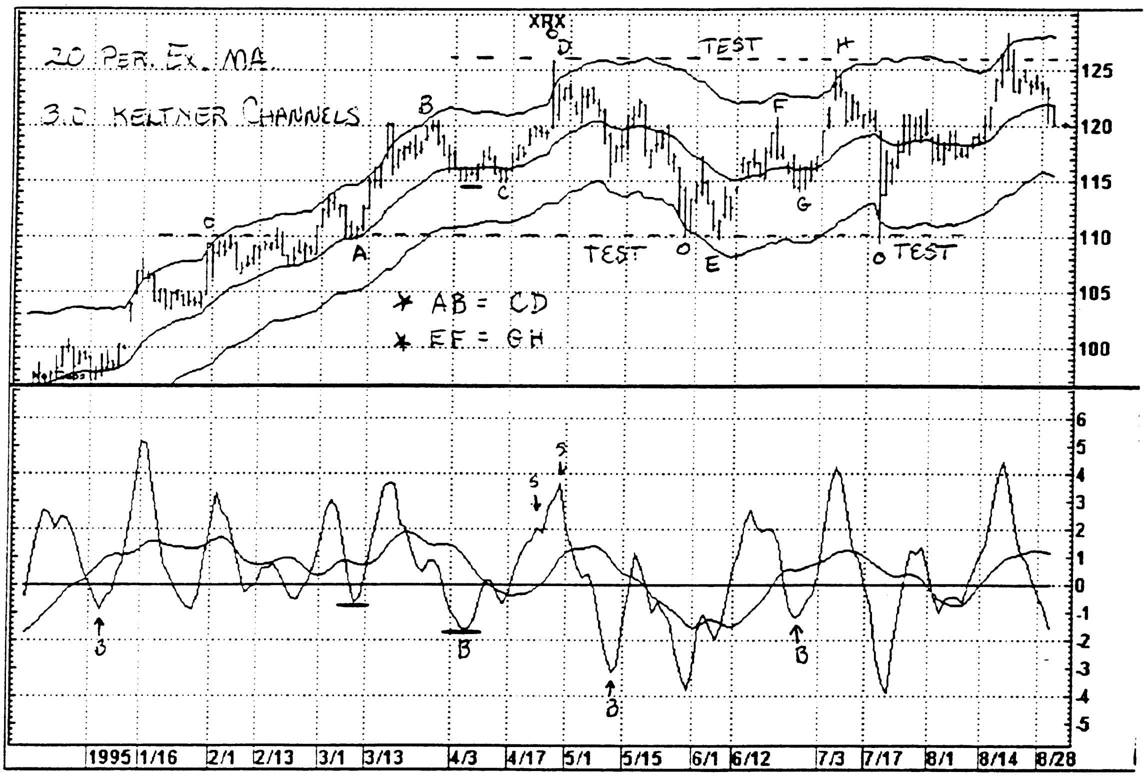


Figure 20

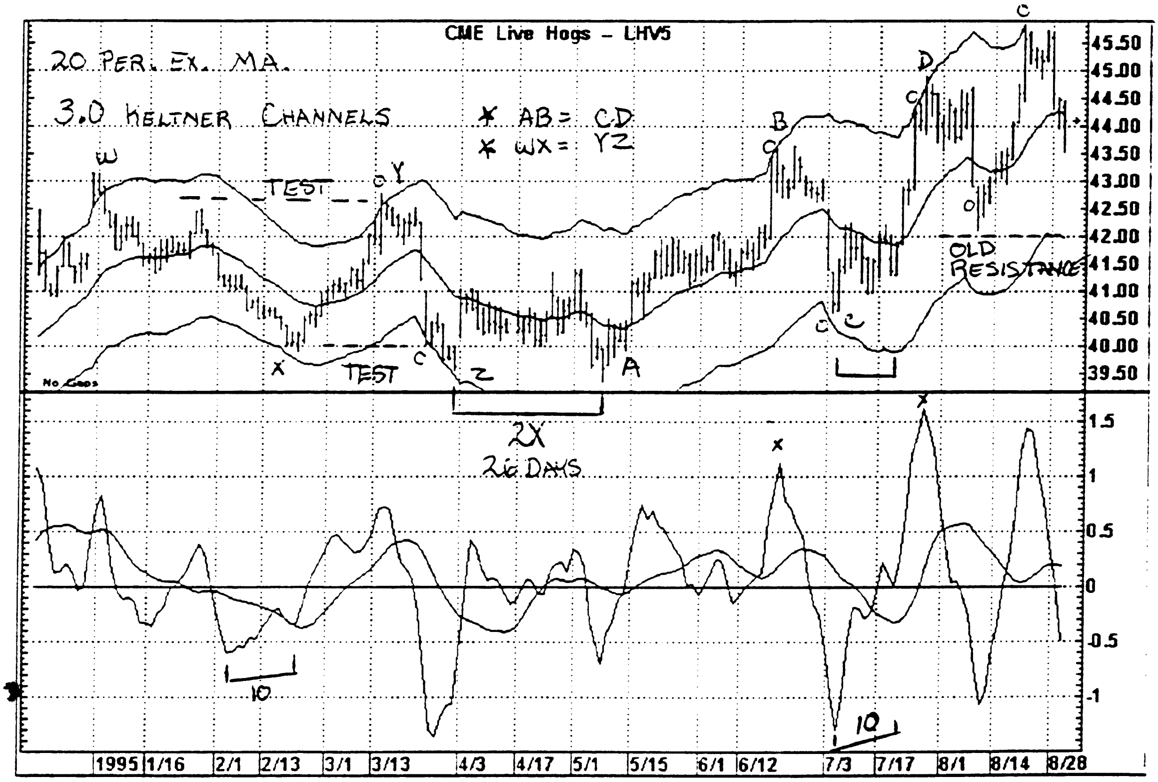


Figure 21

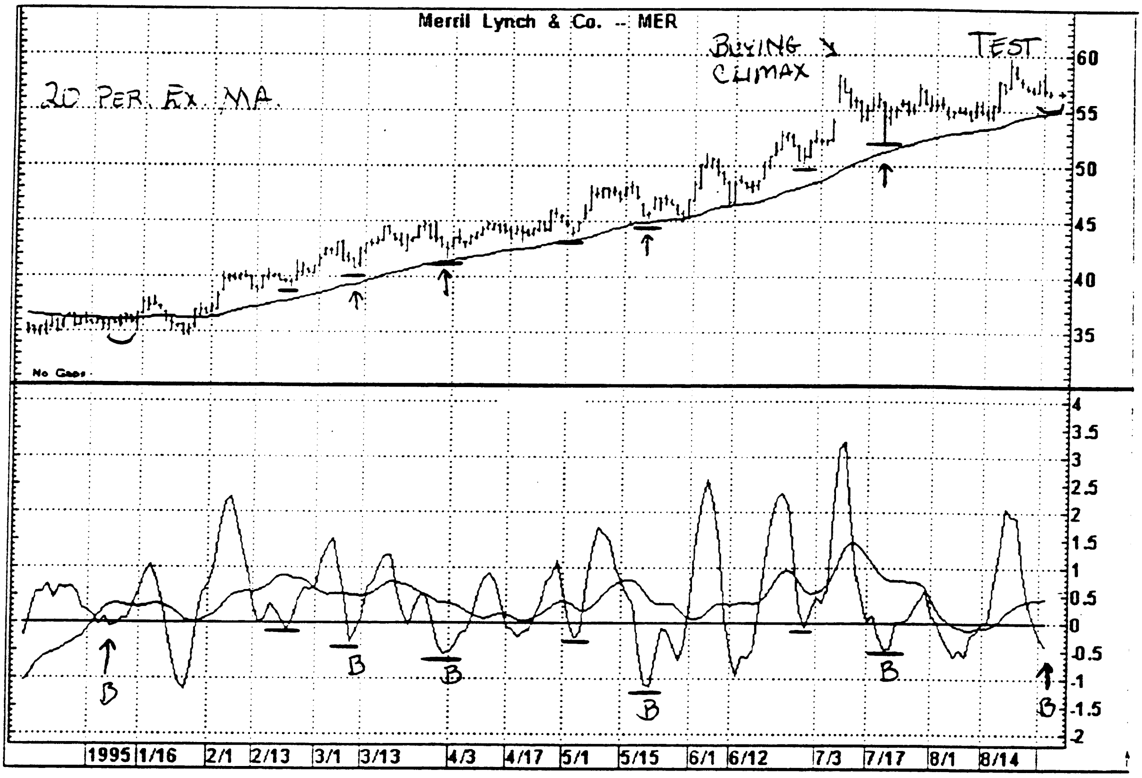


Figure 22

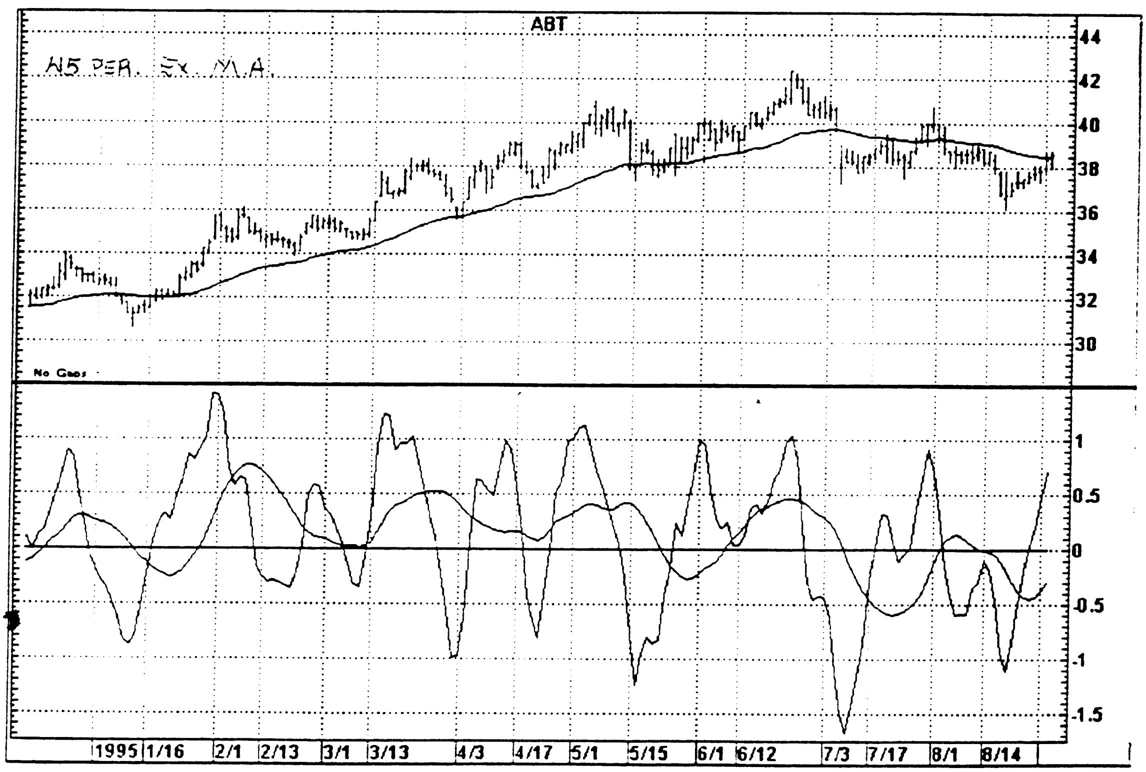
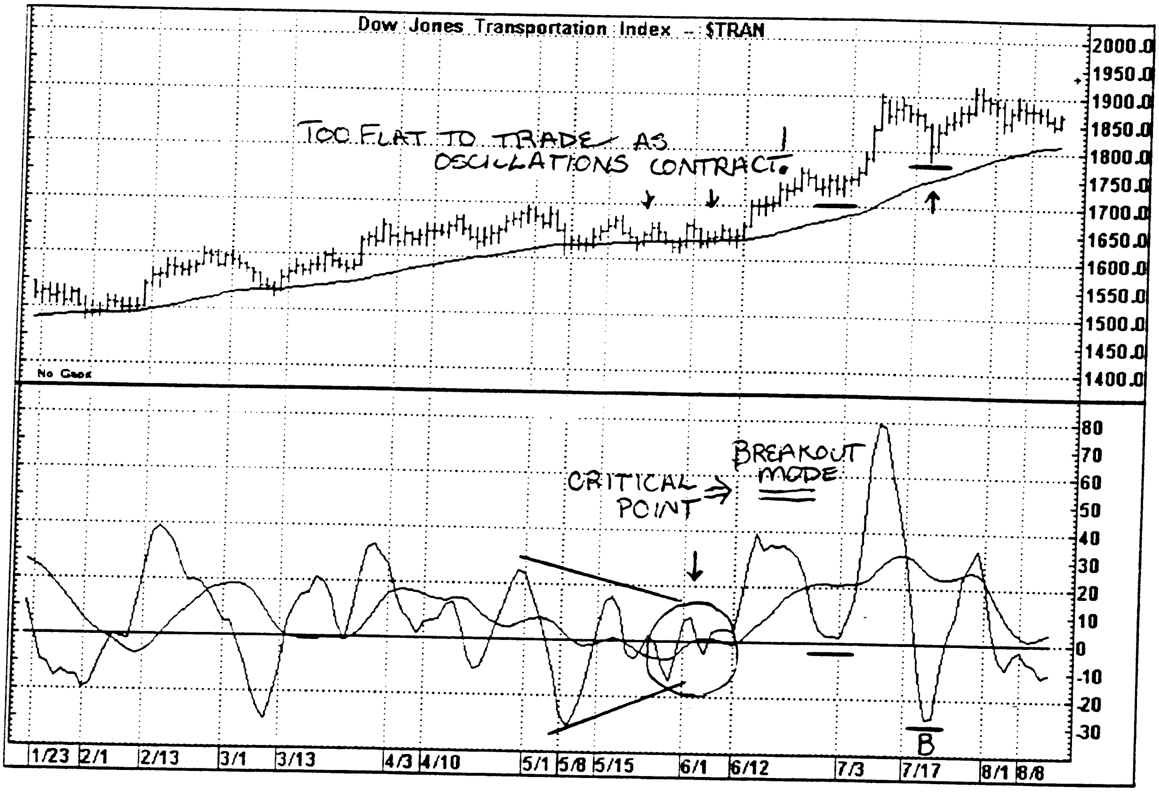
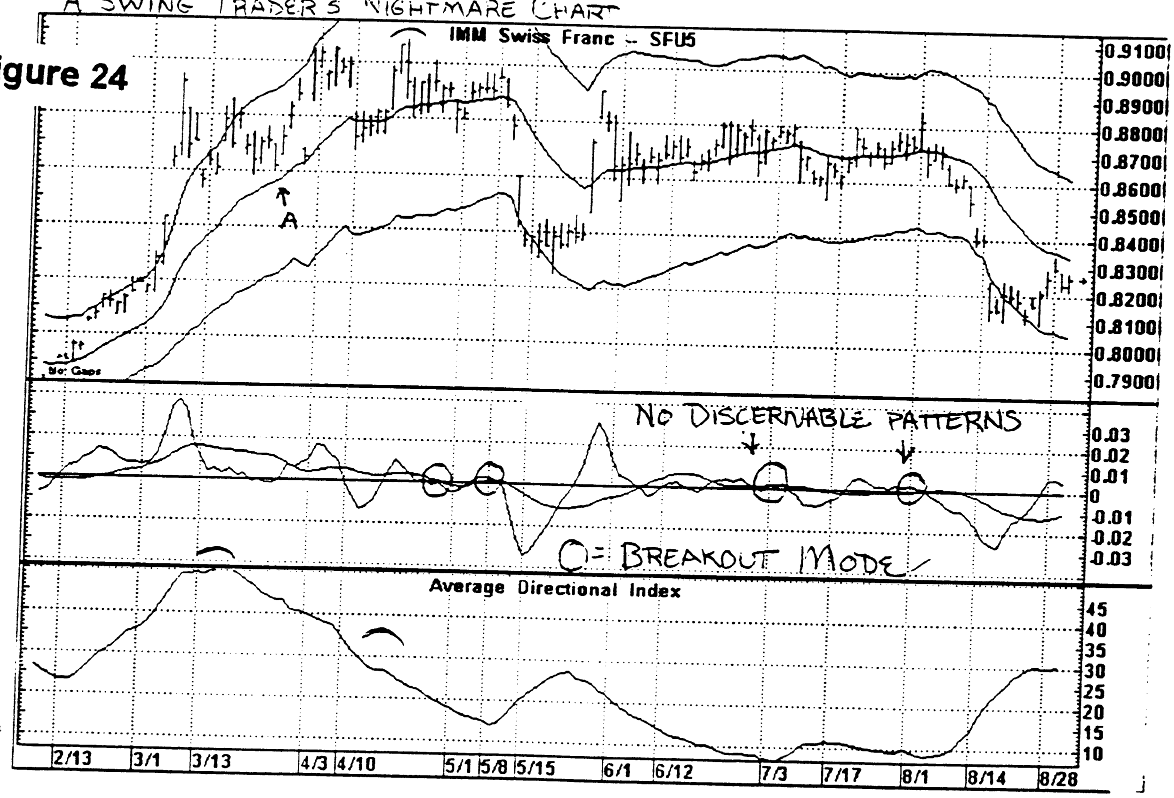


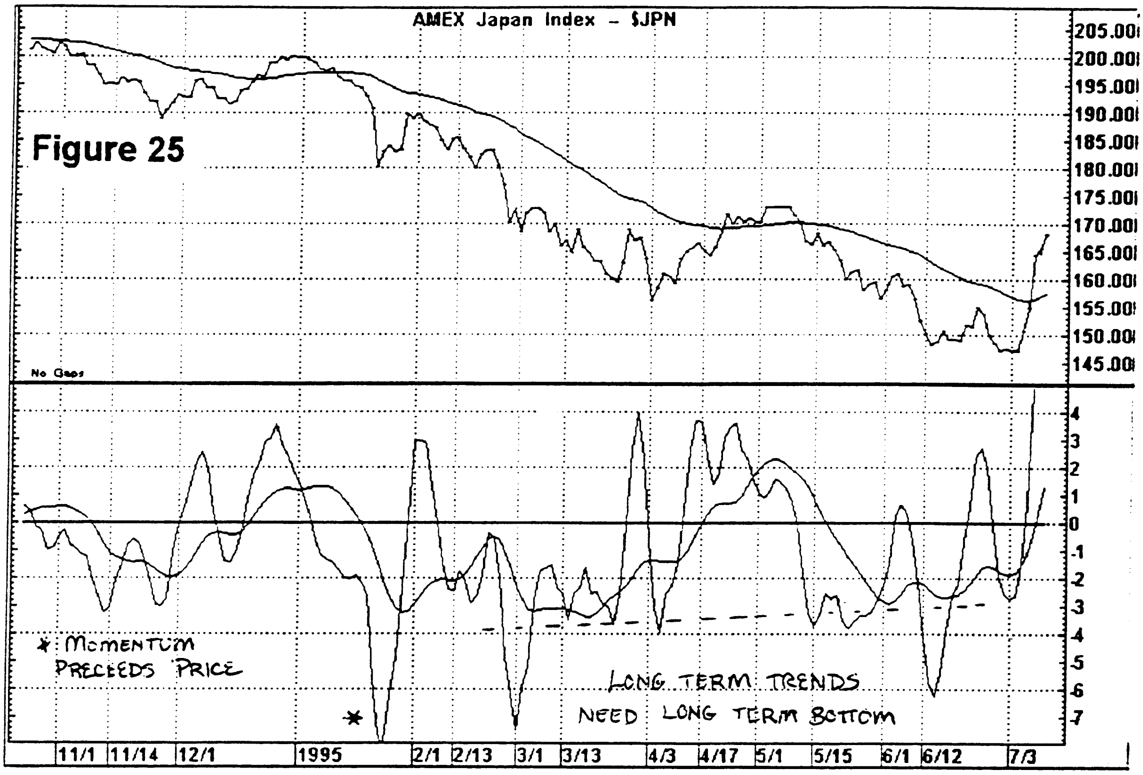
Figure 23

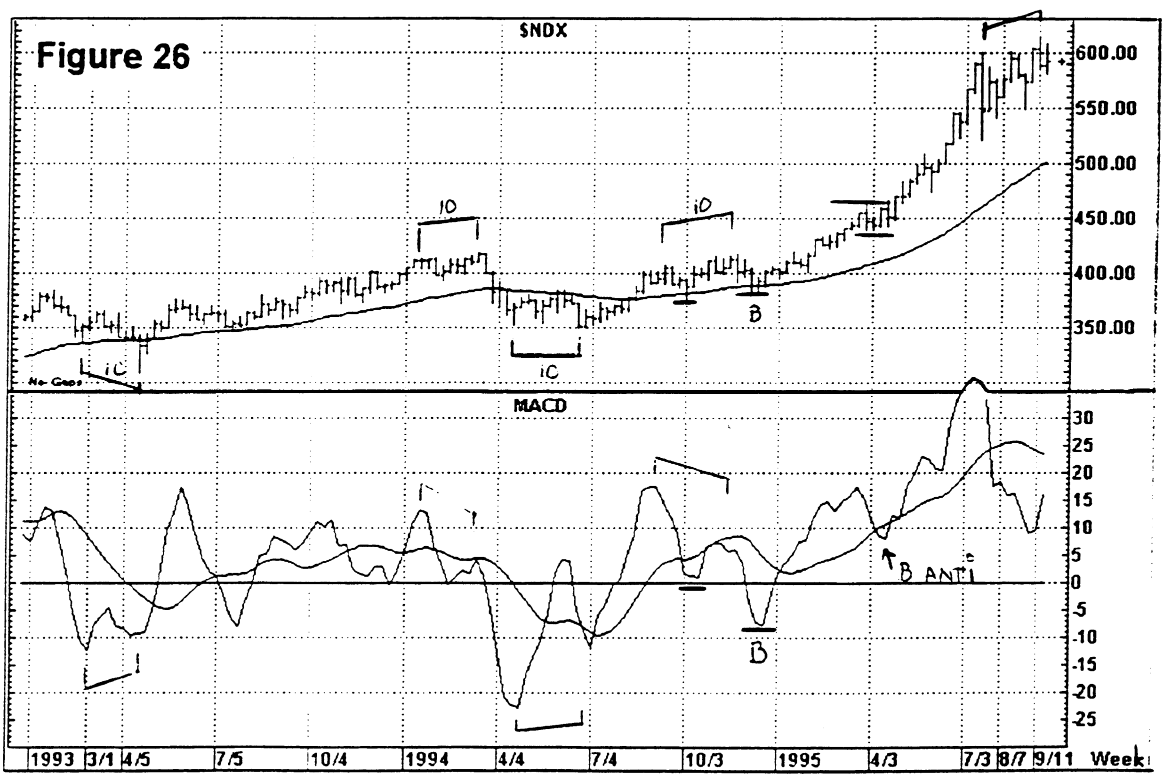


A SWING TRADER'S NIGHTMARE CHART

Figure 24




AMEX Japan Index - $JPN
Figure 25
205.00
200.00
195.00
190.00
185.00
180.00
175.00
170.00
165.00
160.00
155.00
150.00
145.00
No Gaps
* MOMENTUM PRECEEDS PRICE
LONG TERM TRENDS NEED LONG TERM BOTTOM
11/1 11/14 12/1 1995 2/1 2/13 3/1 3/13 4/3 4/17 5/1 5/15 6/1 6/12 7/3


$NDX
Figure 26
600.00
550.00
500.00
450.00
400.00
350.00
No Gaps
MACD
B ANTI
1993 3/1 4/5 7/5 10/4 1994 4/4 7/4 10/3 1995 4/3 7/3 8/7 9/11 Week

Principles of Management

Manage the Positions

A pattern, methodology, or system must have workable entries, exits and stops. They must be workable in that we are able to monitor and trade multiple positions at once. This means that sometimes the ideal trade location is sacrificed in order to simplify execution and keep a realistic and systematic approach to trading. Diversification is always realized at the expense of trade location.

Manage The Mechanics

Make a game plan before the market opens. Have orders written out. Know what to buy or sell, when to buy or sell, and when to stay out. After market hours, record trades made. Update charts and record prices. Then, go play to let out the stress! Do your analysis work later, as your mind becomes too cluttered when doing the updating work. The next morning, <u>BEFORE</u> the openings, phone in your resting orders and catastrophic stops. This is your safety net against freezing during the day.

Manage the Bad Trades

This is the most common block to success. What this really means is, managing to get <u>OUT</u> of the Bad Trades. So, don't manage a bad trade, get out and manage to get out sooner rather than later. Otherwise, all the energy goes into watching a bad position and the good trades get left on the table. Have you ever noticed how it takes three times as much energy and emotion to watch a loser as opposed to a winner?

Manage Yourself

Keep yourself functioning! Strive to keep yourself functioning at your best. Do not allow yourself to become too intense. Concentration requires oxygen to the brain and worrying will affect this. Contrary to what certain peoples' work might lead you to believe, spending more hours on analysis does not make you a better trader. Never make trades when depressed - the odds of self sabotage are too great.