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COVER

Multi-Market Traders Rule!

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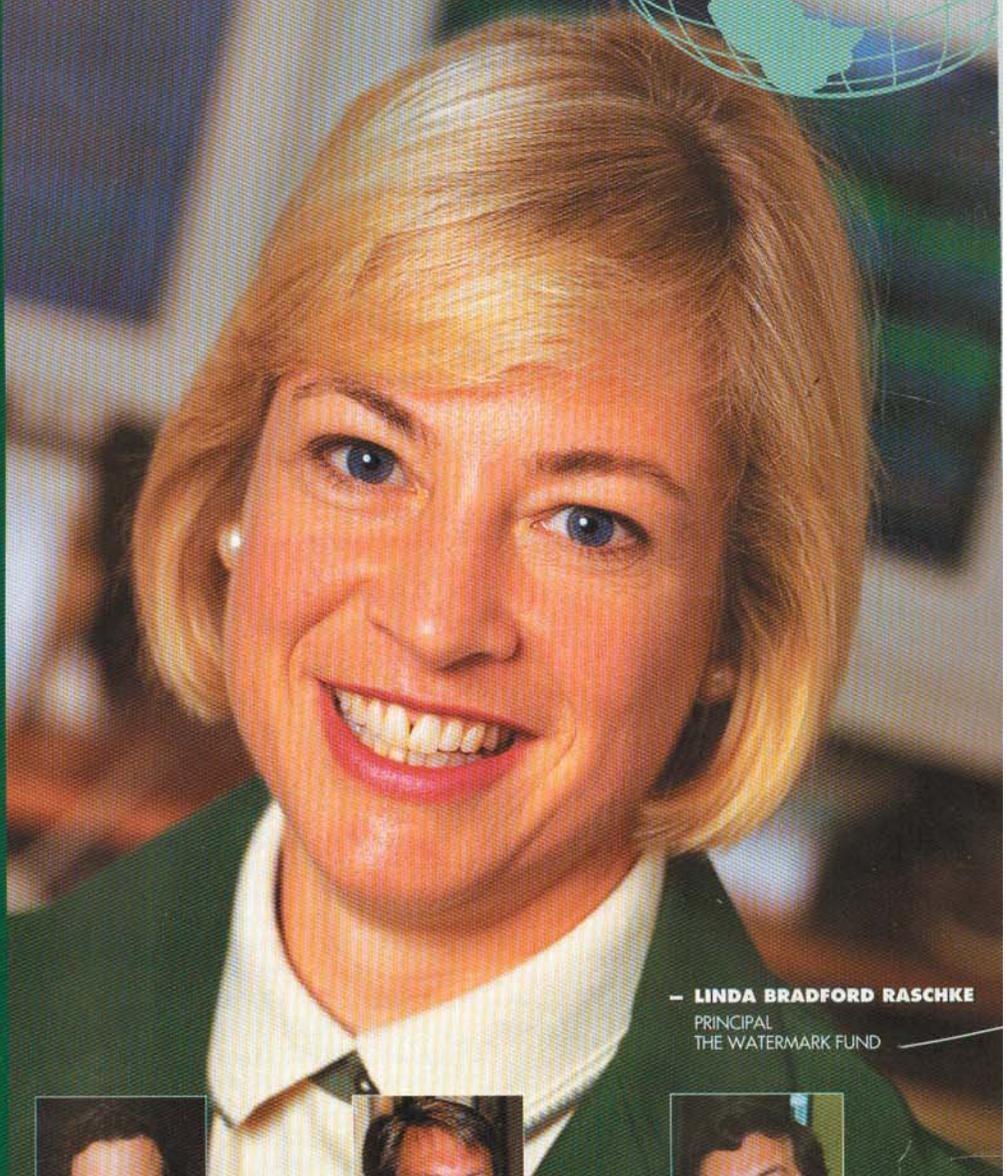
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— **LINDA BRADFORD RASCHKE**
PRINCIPAL
THE WATERMARK FUND

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**MULTI-MARKET
TRADERS RISE TO THE
CHALLENGE**

They Want it All

Photo: Joanne Dugan Photography

"If I have a core position that's working out, the best thing to do is leave it alone," says Linda Bradford Raschke, multi-market trader. "That's the beauty of a multiple market approach, because I can distract myself elsewhere."

In these days of increasing specialization, where a trader's job title alone can run to two sentences, the all-round trader who is comfortable (and profitable!) trading multiple markets seems to be becoming an endangered species. Trading desks are often staffed by specialists, not generalists, as markets mature and clients demand an ever-greater depth of analysis and specific expertise. Multi-market traders need not only the expertise to compete effectively with their specialist counterparts but also the breadth to do so across many markets and time zones. Add the day-to-day labor of multiple-position management, and you

have a surefire recipe for schizophrenia, disaster or both.

Yet for some, the challenges and variety of opportunity are seemingly irresistible. Linda Bradford Raschke has been a multi-market trader for virtually all of her 18-year trading career, since starting on the floor of the Pacific Coast Stock Exchange as an equity option market maker (where she wore a green trading jacket the same color as *FT*'s cover traders!). Though she was required to make markets in a minimum of five or six underlying stocks, it was quite common for her to have positions in up to 20 different

stocks. "From day one, I got used to the idea of following what I liked to think of as my 'stable' of markets," says Raschke. "The culture on the floor was generally skewed toward a multi-market approach, with some 30 percent of traders also dabbling in unrelated markets on other exchanges," she says.

"For me, the definition of a trader is someone who's always going to where the opportunity is," Raschke says. "There's no point in staying with a market if it has dried up. Having said that, it was probably three years after I left the floor and moved upstairs that I started trading markets other than the financials. I had previously turned up my nose at these markets, won-

BY ANDY WEBB

COVER STORY

dering why anyone could want to trade corn when index futures offered such opportunities. It was only when I started to consider the idea of a managed futures program that I started to take the idea of trading in those additional markets seriously." (In October of last year, Raschke closed down her CTA operation, which showed a net gain of 116 percent over its three and a half year life, with peak funds under management of \$34.5 million. She is currently in the process of moving both office and home from New Jersey to Florida, where her new offshore Watermark Fund will start trading on October 1st.)

For some traders the downside of trading multiple-markets is the stress of position management. The problem isn't always that being spread too thinly results in a "blow up" of epic proportions. More often the damage inflicted on performance is more insidious. If a trader has half a dozen positions on at once, the likelihood is that at least one will be performing well. As a result, there is a tendency to be rather more forgiving of positions that are not immediately successful, particularly those where the leverage is relatively small.

Interestingly, Raschke cites the multi-market approach as beneficial in handling the opposite problem – the position that's going well. "If I have a core position that's working out, the best thing to do is leave it alone," she says. "That's the beauty of the multiple-market approach, because I can go and distract myself elsewhere, where I'm not going to get hurt. With possibly 60 percent of my profits coming from the S&P, it would seem logical to trade nothing else, but trading multiple markets stops you getting too biased or attached to any single one.... Taking a point out of the cows (for example) may not even add 0.01 percent to your bottom line, but sometimes you need it for a psychological 'kicker.' That's vital, since you need to be in top mental condition to spot and load the boat on the big trade that may make your quarter."

ONE SIZE FITS ALL

One of the more contentious issues for multi-market system traders is the debate of single-versus-multiple methodologies. One school of thought points out that hogs and T-bonds are very different animals and that it's unrealistic to be able to apply the same trading method to both. The other school says that if your system is robust, it should work well across all markets.

Raschke falls into the latter category. "If you have a decent methodology, it works on any market – even if it's trading horses," she says. Raschke trades most US futures markets. "I like to watch the price action and read the tape, and that pretty much rules out the overseas markets. There's no reason for me to stress myself at 3:00 am following the FTSE or something. We have around 20 good domestic futures markets where you can always find something to do."

OVER THE POND

Having said that, Raschke does trade overseas markets – but on a purely mechanical basis and with a lot less leverage. A popular justification for this approach is that maintaining at least a small presence in a lot of markets means that a trader is already there when the action happens. Dipping a toe in the water with a small position also gives a feel for the market and its characteristics. Whereas inter-market analysis is hardly a new concept (floor traders who may never stray beyond the S&P will probably at least watch the bonds), the true multi-market trader is doing such analysis in spades and hopefully capitalizing on it.

At its simplest level, those who trade overseas stock index futures and can relate the activity to the domestic market are a case in point. The reac-

tive nature of contracts such as the FTSE future on Liffe means that they often play "catch up" each morning on the previous night's S&P close. Noise, centered on opening gaps, is typical behavior. The proficient multi-market trader will use that information to adapt their trading style and set up strategies that take advantage of moves off the opening price, such as short-term volatility breakouts.

NO CORRELATION

Another hot topic for multi-market traders is correlation between markets. As one argument for multiple-market trading is the benefit of having a diversified portfolio, many traders will shun simultaneously holding positions in related markets. Purists insist that if you're long Deutschmarks, you don't go long Swiss franc as well and risk skewing the distribution.

Raschke's approach to this is less orthodox and is in part related to her ambition to be where the action is. "I'm not bothered by being in related markets at the same time, because sometimes one market will move and the other won't. In those situations you'll know a good move is coming up and it's like Murphy's law – you hit one and it's the other one that breaks first! I figure that if I got a little bit of both on, then I can cover both bases."

Despite the apparent contradiction,



"Our principal strategy is selling credit spreads," says Marcus Rodriguez, head trader at Quantitative Asset Management, pictured on left with partner Tom Wagner. "So on bullish signals, we'll be selling put spreads, and call spreads on bearish ones."

Raschke is a great believer in being a specialist. "If you're going to be successful, you've got to specialize and be really good at one thing," she says. "By focusing on just one or two markets, you can pick up the nuances of their behaviors and capitalize on them. If you're trading multiple markets, you're still specializing, but in a pattern or system and then running that across a portfolio – to anything from Swiss francs to pork bellies." On that basis, the multiple-market approach lends itself well to technical rather than fundamental analysis. If currencies dry up and stagnate, you take your business elsewhere and plug those techniques into a new market.

Conventional wisdom that multi-market managers tend to operate on a system rather than discretionary basis gets short shrift from Lois Peltz, managing editor of MAR (Managed Account Reports). Peltz points to prominent discretionary traders such as Paul Tudor Jones and Louis Bacon, who have gone into multi-market hedge fund strategies as well. "Hedge funds in general tend to be discretionary, not system, traders," she says.

"The classic example is the global macro fund that trades multiple markets and countries. Very few of those use a systematic approach. The benefit of being able to adopt a multi-market approach is the ability to go where the opportunities are. The overall result of that is that their performance may be smoother, whereas single/narrow market traders may show more volatility. You see this if you compare from our tables the diversified traders with those that specialize in just currencies or financials (see chart). Since 1990, diversified have had one down year and averaged 10.8 percent annually, against 13.6 percent for currencies and 14.2 percent for financials for the same time period, both with two down years. Less volatility, but more consistent returns, would appear to be the outcome of the multi-market approach."

OH, THOSE DETAILS

In some ways, trading multiple-markets appears to beget multiple headaches. Order execution and costs are obviously a key factor for any trader, but the problem (if there is one) is exacerbated for the multi-market trader – especially those using mechanical systems. A common approach is for these traders to use resting orders in the market place, such as buy and sell stops. For those

operating in this fashion on a short-term basis, quality of execution becomes of paramount importance, as it can easily account for 50 percent deterioration in performance. Those who are successful with this style inevitably tend to be aggressive in demanding perfect execution from their brokers.

Multiple-market trading will typically also involve managing multiple broker relationships. The best executing firm for Japanese yen is not necessarily the best for lumber! Multi-mar-



"We use momentum and the derivatives of momentum as the basis of our analysis in all markets," says Herve d'Halluin of Ixorcap. "The element of automation makes our positions manageable."

ket traders don't enjoy the cost economies of scale that their one-market cousins do. Spreading 100 contracts among five markets (and possibly brokers) will cost more in commissions than putting them all in one.

On the regulatory and administrative front, while trading multiple-markets geographically may impose no significant additional workload, crossing product boundaries almost certainly will. Trading multiple products, such as arbitraging cash equities and index futures, involves extra administrative work by adding the SEC as well as the CFTC to the equation. By the time blue-sky laws in each individual state have been complied with, the regulatory workload could well triple.

GRAB BAG

Various traders use different methods to reduce the potential stress of multiple-market positions. Trader Paul Forchione specializes in multi-market option volatility strategies on

Opportunities in Options' new CTA program, and currently has some \$2 million under management. "By being a neutral or volatility trader you effectively slow down the speed of the market and the number of trades or adjustments you have to make," he says. "This doesn't just reduce the stress of managing multiple positions, it also dampens the volatility of your profits and losses in comparison with an outright directional trader."

Multi-market option traders not only need the same breadth of knowledge as their counterparts in the futures and cash markets – they need some extra depth as well. For a start, they also need to be well informed on the individual volatility characteristics of the markets, in particular the volatility skewing. "It's very important to understand how very different from each other markets can be in this respect," says Forchione. "Grain markets and the S&Ps both have very pronounced volatility skewing – but in different directions. The S&P tends to have very high implied volatility on out-of-the-money puts, whereas grain markets exhibit similar volatility on the out-of-the-money calls. Both markets demonstrate very different elasticity of volatility as well. S&P option volatility will generally tend to spike most on sharp declines, though grains will exhibit similar behavior on rallies. In addition, you have to be aware of how markets' characters can change over time. Look at sugar – it used to be one of the most volatile commodities, now it's hard not to fall asleep trading it."

There are even artificial intelligence traders that use a multi-market approach. Quantitative Asset Management in New York uses artificial intelligence techniques that have multiple-market inputs. The firm uses the results of such analysis when selecting covered stock option writing strategies. "We use a mixture of our own proprietary neural networks and Market Technologies' VantagePoint system," says manager and head trader Marcus Rodriguez. "Both techniques use multi/intermarket analysis to give us a projection of strength or weakness in the stocks. Our principal strategy is selling credit spreads. So on bullish signals we'll be selling put spreads, and call spreads on bearish ones."

These artificial multi-market traders use inputs from a range of US markets including long- and short-term interest rates, gold and the US dollar/Japanese

yen exchange rate. It also takes into consideration data from international markets such as the Nikkei and FTSE stock indices. "Though actual trading activity is focused on the domestic market, the networks can filter and analyze multiple-markets to give a dispassionate signal not clouded by human emotion," says Rodriguez's partner Tom Wagner.

CROSS-CULTURAL THANG

The theory that it takes a particular personality type to be a multi-market trader is not universally accepted. "I don't think there is any difference," says Herb Weiss, senior VP for equities at ING Barings in New York. "I've traded US and international stocks, going back and forth between them for the last 12 years. Trading is trading." Weiss does however note a particular ability that is necessary. "You have to understand other peoples' cultures," he says. "Trading is a people thing, it's an information gathering process where understanding the culture helps you to understand the way they trade. Just 10 years ago the difference between trading US and Canadian stocks was substantial."

Weiss feels that the biggest cultural gap domestic US traders have had to bridge has been different trading styles on international equity markets. Although this is gradually changing, European and Asian traders have historically traded for the book rather than facilitating customers as they do in the US.

"I don't think that multi-market experience necessarily makes you technically a better trader," says Weiss, "though it's obviously a useful addition to a trading background. Trading emerging equity markets certainly requires a very different skill

set than for US markets. For example, lack of depth and turnover requires holding positions for longer periods. You have to combine proprietary characteristics with facilitation."

Weiss also points to the greater awareness of global macro economic characteristics as a trait among those who trade markets internationally. "The US is traded by sector, whereas Europe is traded by country, which requires a greater awareness of these issues. As markets develop, business flows to the home market. That is illustrated by comparing markets such as Japan, where activity is concentrated domestically, with Korea, which is still mostly traded in ADRs and special foreign OTC stocks. I don't think that this increasing specialization will take away the need for the multi-market trader - I think instead you'll see people who trade industries around the world as opposed to countries."

SYSTEMATIC TEAMWORK

Paris-based CTA Ixorcap regularly trades in 40 different markets around the world. A typical trading day can require covering positions from very early in the Paris morning for markets such as Simex, to 10:15 at night in Paris when the S&P closes in Chicago, though longer trading hours in the electronic sessions available in many markets have improved the situation for Ixorcap's traders.

"We emphasize interest rate products, with an average of 10 to 12 positions open at any one time," says Chief Operating Officer Herve d'Halluin. "We only trade futures, since they allow easy diversification, liquidity and flexibility." In the year to June, Ixorcap's programs were up 13.3 percent.

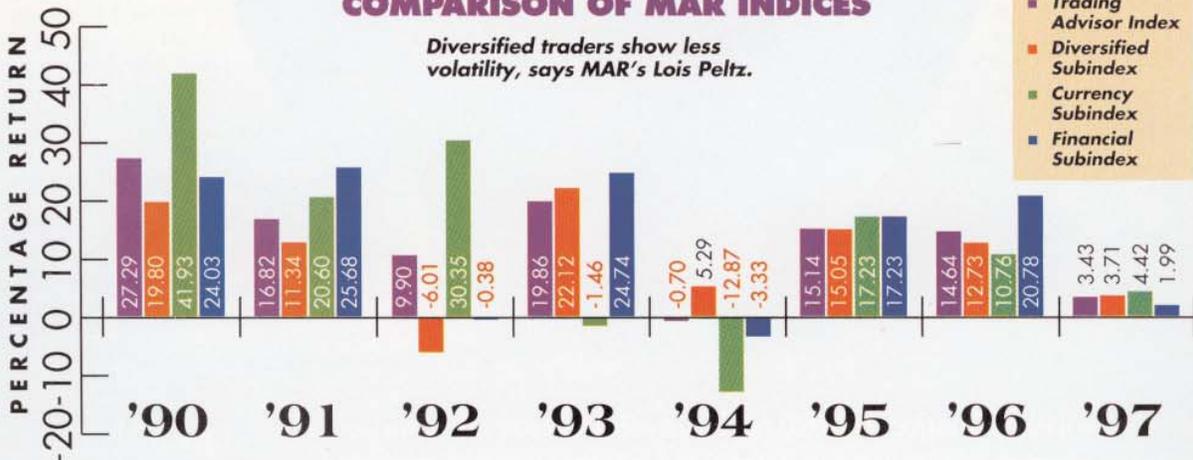
A discretionary element to Ixorcap's trading activity is used for risk management. With much of its activity concentrated on interest rate products, the company is sensitive to correlation risk. For example, it's quite common for the Ixorcap's trading system to produce multiple signals in the same direction if, say, global bond markets turn bullish. When that happens, the firm has the discretion to select one market as a benchmark and then control the risk and size of the global exposure relative to the benchmark.

However, d'Halluin considers the firm's systematic approach as crucial in Ixorcap's ability to follow 40 markets effectively. "That's much harder to do for a fundamental trader looking at macro economics," he says. "We use momentum and the derivatives of momentum as the basis of our analysis in all markets. The element of automation makes our positions manageable." The firm's short-term - two or three days - and multi-market approach has shown in the past very little performance correlation to mainstream trend followers and international bond and equity indexes.

With that sort of systematic approach, the method for implementing, tracing and allocating trades has to be good. D'Halluin highlights efficiency of the back office system as being critical to the multi-market process. "We currently have a team of four, with about \$12 million under management (though \$20 million is more typical and we expect to raise more funds in the near future because of our consistent performance)," he explains. "With good productivity, you can manage a substantial amount of money with a small team." ■

COMPARISON OF MAR INDICES

Diversified traders show less volatility, says MAR's Lois Peltz.



Source: Managed Account Reports