

ADVANCE REVIEWS

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TRADING SARDINES

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**LESSONS IN THE MARKETS
FROM A LIFELONG TRADER**

LINDA BRADFORD RASCHKE



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Press

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This book reflects the author's recollection of events over time. Some experiences have been compressed, and some dialogue has been recreated. My mom disputes the Scrabble story. And she says I did not actually sleep in a converted tool shed off the garage. But I have done my best to make this a truthful story. No names have been changed to protect the innocent. There was no need to make up events either since truth is stranger than fiction.

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“The Edge... there is no honest way to explain it because the only people who really know where it is are the ones who have gone over.”

—Hunter S. Thompson

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INTRODUCTION

Iwrote this book because nobody could believe all the crazy things which have happened to me in the financial trading industry. When I was a market maker on the Philadelphia Stock Exchange, the specialist in the pit where I stood said, “Truth is stranger than fiction.” It is impossible to make these events up. I started out trading in San Francisco on the Pacific Coast Exchange where there was one of the best business libraries in the country. The first book I checked out was about catastrophe theory. This is a concept used to show how gradual changes to a system can produce sudden drastic results. A stock market crash is an obvious example. It never caught on as a legitimate model of price behavior because it had no predictive value. But it opened my eyes to the fact that there is so much that we can’t model. We live in an abstract nonlinear world that is in conflict with our human biases.

Despite the increased awareness over the past two decades of black swans, fat tails, and chaotic events, otherwise known as “outliers,” people tend to be more comfortable engaging in straight lined thinking. Fuzzy variables are messy. The unknown is uncomfortable.

Yet trading is about decision making under uncertainty. This is my journey as a trader where my knack for being on the wrong side of outliers and unforeseen events is well beyond random. Some of the challenges and obstacles along the way were self-created. Some were plain old bad luck. But part of this story is about how to pull yourself up by the bootstraps yet one more time and keep a positive attitude. How to persevere, the work and single-mindedness required to succeed, and above all, how to maintain a healthy sense of humor to keep one's sanity.

It was not my intent to write an autobiography but to share some of the more interesting and useful lessons I learned on my journey. Hopefully, an astute trader will get some ideas to further their own research or see different ways of looking at things. For those who are newer to the financial trading industry, it might be an eye-opener as to how many potholes can pepper the road to success.

Nothing is ever as it seems. This was one of the first stories I heard on the trading floor:

“Trading Sardines”

An older gentleman was walking along the wharf watching the fishing boats return from a hard day's work. Hands clasped behind his back, he inhaled the salty air into his lungs and listened to the seagulls' caw as they chased after the fishermen. When he opened his eyes, he saw a group of men crowded at the end of the wharf about 50 yards away. They were raising their hands in a hurried commotion. Curious as to what the fuss was all about, the man moved closer and closer until the caws from the crowd overtook the caws from the seagulls. He slid between the men until he was in the middle of the action. An Asian man perched on top of a box in the middle of the crowd. He was a small man, with dark leathery skin, and deep wrinkles around his eyes. His sleeves

were rolled up, and he was pointing at different members in the crowd. The older gentleman looked around and saw they were bidding on a rare can of sardines. “Hundred dollar bid, hundred dollar bid, now one ten, now one twenty, will you give me one thirty?” The energy from the crowd was infectious. Overcome with emotion, the gentleman started raising his hand too, driving the bid even higher.

“One sixty bid, now one sixty-five, will you give me one seventy? One seventy bid. Going once, going twice.” Heart racing and determined not to be outbid, the gentleman raised his hand and shouted, “One seventy-five!” The auctioneer twirled around and said, “Sold!” The gentleman could hardly believe it. He was the winner. He tried to catch his breath as the other men patted him on the back and dispersed back to their homes for supper. The gentleman couldn’t wait to get back home to show the prize to his wife.

Beaming with pride, he presented the rare can of sardines to his wife. She smiled at him and brought the tin over to the dinner table. They both sat down, preparing to feast on the delicacy the gentleman won. He hooked his finger around the tab and pulled the lid open. An awful stench hit him in the face. The can of sardines was rotten! The wife cried out as the gentleman jumped to his feet and raced out of the house back down to the wharf. He found the auctioneer cleaning up from the day and explained to him what happened, demanding a refund. The old man let out a laugh and said, “You silly fool, those were trading sardines, not eating sardines.”

Don’t place valuations on the things you are trading.

A LESS THAN AUSPICIOUS START

Ilost everything.

Tears streamed down my face. I wondered, “How the fuck do I get myself out of this one?”

The year was 1982, and I was as wide-eyed as Dorothy first gazing upon the marvelous Emerald City. However, in this story, Dorothy ends up accosted by munchkins trying to outbid her every move and in debt up to her eyeballs to the Wizard of Oz after she had her ass handed to her by the Wicked Witch of the West. Unfortunately, no sparkly red shoes were going to save me from this one.

Having recently graduated college armed with a degree in economics and music composition in one hand and a chunk of student debt in the other, I moved to San Francisco to make my fortune as a stockbroker. I rented a tiny apartment with three girls who all thought it was a fantastic idea to paint our living room Pepto Bismol pink. We lived one block from the corner of Haight and Ashbury, so anything went.

Since I didn't have a last name like Rockefeller or Vanderbilt and thus zero access to a ton of ridiculously wealthy relatives who could become clients, I was rejected by every brokerage firm in San Francisco. Determined not to give up on my goal, but desperate to pay the rent, I ended up getting a job as a financial analyst at Crown Zellerbach. It happened to be across the street from the Pacific Stock Exchange. I didn't know what the Pacific Stock Exchange or "PCX" was at the time. I soon learned that it was one of four exchanges in the country that traded equity options.

Listed equity options had been around for less than a decade, so the trading floor functioned like the Wild West. Arbitrage opportunities were abundant. To oversimplify, arbitrage means exploiting a mismatch in price on different markets. Imagine you're grocery shopping and you see the cost of butter is \$1.00 at Walmart and \$2.00 at Target. You could buy the butter at Walmart for \$1.00, walk across the street and sell it at Target and pocket \$1.00. It was that easy. Of course, technology eventually led to efficient markets.

The building which housed the Pacific Stock Exchange was a product of the 1930s and fused together the previously standing classical architecture with the art deco style of the time. Ten imposing columns lined the entrance to the exchange giving it a stately appearance. A passerby would have no clue of the chaos that ensued inside.

Every morning, traders wearing jackets of green, orange, purple, some striped and all decorated with badges, streamed down the granite steps of the exchange in search of coffee, breakfast, and cigarettes. They resembled jockeys lining up before the next big race. Traders in New York stopped for lunch. With San Francisco three hours behind, this meant a pause for bagels and a game of backgammon. A friend introduced me to one of these colorful characters, a trader named Gerry.

Gerry was a lean, wiry man. He had a thin mustache that hid even thinner lips which were perpetually curled up like the Cheshire

Cat. Before becoming a trader on the floor, Gerry had been a mathematician. He drove an antique black Mercedes convertible with a license plate which read "THX TDY." TDY was the symbol for Teledyne, a high-flying tech stock in the early eighties. Gerry made handsome profits thanks to the volatility of Teledyne.

Eager to know more about precisely what Gerry did for a living, I invited him to play tennis. Gerry was a great tennis player. He had an intense focus and never took unnecessary risks to win a point. It was Gerry's turn to serve. Pivoting his weight to his back foot, he threw the ball into the sky and whacked it across the net in my direction. Right hand ready, I smashed the fuzzy yellow ball back over the net.

As we hit the ball around, I knew I had the opportunity to pick Gerry's brain about trading on the floor. Mind racing, where to begin... What do you do down there? *Too general*. How do you buy an option? *Too simplistic*. How do I unlock the mysteries of the universe to seize financial independence? *Too desperate*.

I inhaled deeply and paused. "What is a market maker?"

Gerry looked at me curiously. "A market maker provides liquidity," he said. "He quotes both a buy and sell price in whatever instrument is being traded."

I furrowed my brow trying to visualize what Gerry had said.

"How do you make money doing that?"

Gerry chuckled. "You make money on the difference between the bid and the ask which is called the spread."

Back and forth we went. I asked Gerry question after question, and he happily supplied me with answers. Our verbal volley mirrored our tennis match.

"Look, you seem pretty interested in this stuff," he said. "If you want, there is a series of tapes back at the clearing firm that covers the basics."

"Oh yeah?" This sounded promising.

“Yeah. Spend some time learning the ropes and then I’ll bring you onto the floor.”

I could hardly believe it. This was my chance to join the ranks of the colorful jacket gang of the Pacific Stock Exchange. I did not fit the image of a stereotypical floor trader. I gave off more of a Barbie vibe with my blonde hair, blue eyes, and slight Valley Girl accent. But was I going to let that get in my way? As if!

Gerry looked me straight in the eye as he was talking. He had stopped blinking, which was distracting. I refocused. This was business, not a game, and he was assessing my commitment. “I’ll supply you with the initial capital and we’ll split the profits 50/50.”

“Deal.” We shook hands and continued to play.

I created my first company and in true clueless form, I named it “Pyramid Trading Company.” I was inspired by the pyramid-shaped Rubik’s cube which dangled from my keychain. In hindsight, I realize how utterly insane a name that was for a company in the financial industry.

I had dedicated every waking moment of the past two months to the tapes Gerry had mentioned. The instructional videos covered topics ranging from how to price options to the intricacies of arbitrage strategies. They explained how a market maker buys and sells inventory and how to use hedging strategies in stocks and options to minimize risk. It was entirely mathematical and filled with dry terminologies like delta, gamma, theta, and implied volatility. I didn’t fully understand all of it, but I took copious amounts of notes. Everything went out the window the first day I stepped foot on the floor. On that day, all I saw was a sea of faceless bodies. It was a twisted blend of *Joseph’s Amazing Technicolor Dreamcoat* with Pink Floyd’s *The Wall*. My throat tightened as I fought to steady my breath. “Here we go.”

The original options floor comprised of 600 bodies pressed up against each other in a small, windowless room. There were 22 trading pits, each listing options on four to eight stocks on 15 screens

dangling overhead. Each trading pit housed 15-20 regulars or “locals” and a handful of “boat people.” These traders were called boat people because they would migrate to wherever the trading action was hot. They were at a slight disadvantage because the locals were reluctant to trade with them. If you formed solid working partnerships with the locals, you were more likely to participate in the order flow. It also behooved you to work a few individual stocks instead of trying to trade multiple stocks. If you had sizable positions on, it could be difficult to exit those trades unscathed.

I made my way through the bodies, wicking sweat off every trader I passed. I arrived at the furthest side of the exchange where a stock called Union Oil (UCL) traded. I strategically picked this pit because the volumes were excellent and the crowd was hospitable. Trading pit territories were fiercely protected so it could be difficult to break in as a new trader.

At the time, there was only one other female trader on the floor, a petite older gal named Kathy. I was the second female trader, recognized by my Dutch Boy haircut. Both of us were seen as a novelty, yet I always felt welcomed as part of the gang.

I stepped into the pit and the traders parted like the red sea. I gulped and walked to the center of the crowd. A ring of armpit sweat down to my waist left a dark stain on my emerald green jacket. As I stood there, I remembered going skinny dipping as a teenager. I snuck out of the house in the middle of the night and joined my friends at the community swimming pool by the Rose Bowl. There were three diving boards to choose from: small, medium, and tall. Unlike Goldilocks, I wasn't given the option of picking the one in the middle. Instead, my friends shoved me towards the ladder of the high dive. More afraid of letting the guys see me sweat than careening into the water below, I ascended to the top. I walked to the edge of the diving platform and peered out into the darkness. I couldn't see the pool below me. “This is it. This is how I die. Tomorrow the headlines

will read: LOCAL GIRL PLUNGES TO HER DEATH, NAKED. What will mother think?" I took one last breath and jumped, not knowing what it would feel like to hit the water below.

* * *

A broker walked over with a sell order. Everyone in the pit turned to me and yelled, "Raise your hand! Bid for one!" My hand shot straight into the sky. Another broker rushed over with a buy order. Again, the crowd shouted, "Raise your hand! Offer it back out!" Like that, I completed my first transaction, flipping one option for a 1/8th profit. The pit applauded. For that one day, I was everyone's little sister. Every day after that, I was just another trading jacket and badge number.

San Francisco traders were true pioneers. In the early years of the PCX, trading volumes were light and volatility was low. An increase in trading volumes and volatility meant more opportunities to profit. In April of 1982, the Chicago Mercantile Exchange introduced what was to become the most popular contract on the CME—futures based on the SP 500. This new contract allowed us to speculate on the future value of the stock market. This piqued my interest. Following Gerry's lead, I picked up the phone and called an order to our floor clerk. "Rick, place a bid to buy one SP contract at 118.45." The SP futures had opened below 120. Today, they trade over 2,700. I closed my trade a whopping three ticks higher which yielded a gain of \$75. It was a modest win, but I'm proud I can say I traded the SPs on the first day they were listed. I traded them every month after that for the next 36 years.

The secret to dealing with the unknown, whether it was walking onto the floor for the first time or trading a new market, is to clear the mind and make your body go through the motions. The sensation is like a tennis player relying on muscle memory. The moment the player starts to overthink the shot is the moment a mistake is made. As a newbie on the floor of the Pacific Stock Exchange with a couple of winning months under my belt, I was feeling confident and ready to

take on the world. Or so I pretended. I had PTSD flashbacks to when I was a kid about to walk onstage for a piano recital. Heart racing, tunnel vision, and for some reason my right arm inexplicitly losing all feeling.

“Who can play the piano with a numb right arm?” I thought as I stepped closer to the worn baby grand in the middle of the stage. I knew my mom would be filling up the front row with a slew of my siblings, but I couldn’t see them because everything was black in my peripherals. “Is this worse than death?” A bit melodramatic, but at 11 years old, it seemed true.

Now keep in mind, the DOW was trading below 1000 for most of 1982. Stocks had a daily range of half a point and volatility was nothing compared to what it’s like now.

Gerry eyed the tape of stock prices scrolling overhead. “Rumor has it there might be a takeover of City Service.”

“Oh yeah? There is definitely an increase in trading activity.” I felt like I knew more than I actually did.

“It’s a risky move, but it might pay off big to sell some straddles.”

Without losing you in technical jargon about the intricacies of options and straddles, all you need to know is this: there is an unlimited amount of risk when you sell a straddle. And I was about to learn this lesson the hard way.

City Service stock was trading around \$34. The options in City Service were marked up in price and the 40-level straddle was trading around \$10. If the stock closed at \$40 on options expiration, the trader would make \$10. If the stock closed anywhere between \$30 and \$50, the trader could still make money. However, if the stock either closed *below* \$30 or *above* \$50, you could potentially lose unlimited amounts.

Remember what I’ve told you so far: the stock was trading at \$34. In 1982 there wasn’t significant price movement on takeover deals. The expiration for the option was at the end of the week and *it seemed as though I couldn’t lose*. In a few days, I could collect my

\$10 and chalk it up as a brilliant move from the surprisingly gifted new trader on the floor.

You ever get a little voice inside your head suggesting you ought not to do something but you go ahead and do it anyway because fuck that little voice, I'm going to make money...

I came face to face with my arch-nemesis: greed.

I sold some straddles minutes before the closing bell. "How can I lose?" I thought naively.

The next morning, I raced to the exchange, eager to check my position.

Trading on City Service had come to a halt. Gulf Oil bid for City Service at \$63 and the stock opened 20 dollars higher than where it had closed.

"\$63 bid? \$63?!? How could this happen??"

This was completely unheard of. Such an outrageous takeover offer had never happened before. Mouth hanging agape, I was in shock. I'm sure everyone could see the panic streaked across my face.

"What have I done?"

I didn't have the capital in my account required to hold my positions. My clearing firm told me to go down to the floor and close out all my open trades. Humiliated, I started a walk of shame from trading pit to trading pit closing my positions, begging for fair prices. The sharks sensed blood and began circling. I could hear murmurs and snickers from the crowd, "We knew she wouldn't last."

This was one of the most embarrassing moments of my life, and it felt as though it would never end. In the midst of all the chaos, time ground to a halt. It was as if the universe was making sure I would always remember this moment.

Gerry had been selling straddles as well, but his trading account was 20 times bigger than mine. I was a mere peon. My total loss was \$86,000, which doesn't sound like much now, but since I didn't have

a nickel to my name, it felt like I had lost \$86,000,000. This 23-year old had lost the cost of an MBA from Stanford in less than 24 hours.

As fate would have it, Gulf Oil, the company which set out to acquire City Service, backed out of the deal the next day. They realized their \$63 a share deal was way too high and the stock opened down 20 points. Since I was forced to close my position the day before, the damage was done. I became an indentured servant to my clearing firm for the next six years as I worked to pay back my losses.

Years later, I became friends with Larry McMillan, a renowned expert on options. He started his career on an equity arbitrage desk. His firm had lost money speculating on Gulf Oil's bid as well except they got spanked when the price dropped. I got spanked when the price went up. As the saying goes, misery loves company.

Larry and I became fast friends as we bonded over our experience with Gulf Oil. I could appreciate that he was an excellent pianist as well. I found out over time that most every trader had experienced early fiascos in their careers. It simply was a matter of surviving.