22
The Big Figure Trade

As noted earlier, retail FX operators are at a disadvantage because they act as a trader's sole counterparty and in this function they are sometimes forced to make artificial markets. Although making markets for clients is most often not an issue for FX brokers since they simply offset their risk in the interbank market, in illiquid times this represents a big problem for them – and an opportunity for the trader.

The Big Figure Trade is one example of how you can take advantage of your retail FCM's limitations. As all traders know, every now and then the market will test a critical level. The actual level is not important, since it may be a well-defined Fibonacci level, a trendline, or more likely than not a big figure. During sharp, one-sided intra-day price moves, the market will often reach a critical level where traders believe it "cannot go higher". Since price moves in FX tend to be self-fulfilling, traders initiate short positions near that level (assuming the pair has been trending higher) and the market will immediately proceed to take them out. Usually there is a nice, big, round number that short sellers set their stops above, confident that an O/B market will not have the energy to push past the presumed option structures and the psychologically important (but often technically useless) number. In these situations, dealers wet their lips as they mount their attack on the stops.

The typical price action is for the price to fail near the figure a couple of times (heartening the short seller's resolve and prompting new shorts) before dealers produce a quick, coordinated attack on the number, overwhelming any option protection and quickly setting off the stops lying above. In an instant, the rate is back below the big figure. Most traders have had this happen to them before – a quick blip and your position is busted, only for it to promptly crash in your expected direction almost immediately. Nothing is more aggravating to a trader than this setup, knowing that your money was so quickly taken away.

This trade works especially well with retail brokers because their fixed spreads and "guarantees" force them to make a market where there is none. When the dealers push the rate higher and trip stops above the big figure, the action is so quick and one-sided (shorts forced to buy back their positions) that in the real interbank market virtually no trading is possible at those prices. Spreads widen and typically only the offer side of the quote runs higher since no dealer in their right mind wants to be long above the figure. Although a true bank dealer may not be able to get a fill at those prices, you can. Because of their fixed spreads, as long as the rate traded is there most retail brokers will fill you at those prices, just as they would have if they were filling your stops instead! This is how traders can fight back and actually use the dealers' tactics against them. The beauty of this trade is two-fold:

1. Your risk is limited and predetermined. If the trade goes wrong, you know exactly how much you are going to lose, which is a big plus when trying to determine position size, etc. Remember that money management should always be at the forefront of your trading decisions.
2. You get to be a thorn in the side of the dealers, which you should consider as bonus points.

Pulling off this trade requires identifying the setup, knowing the dealer's game plan, and staying one step ahead of them.

The setup.

Step 1. Identify the Setup

Look for one-way trending markets, O/B readings, obvious targets (round number). Know your dealer's game plan. You know what they want to do, so trip stops above 150.00 and collect some quick pips. As soon as the stops are tripped, the price will quickly drop back below the figure.

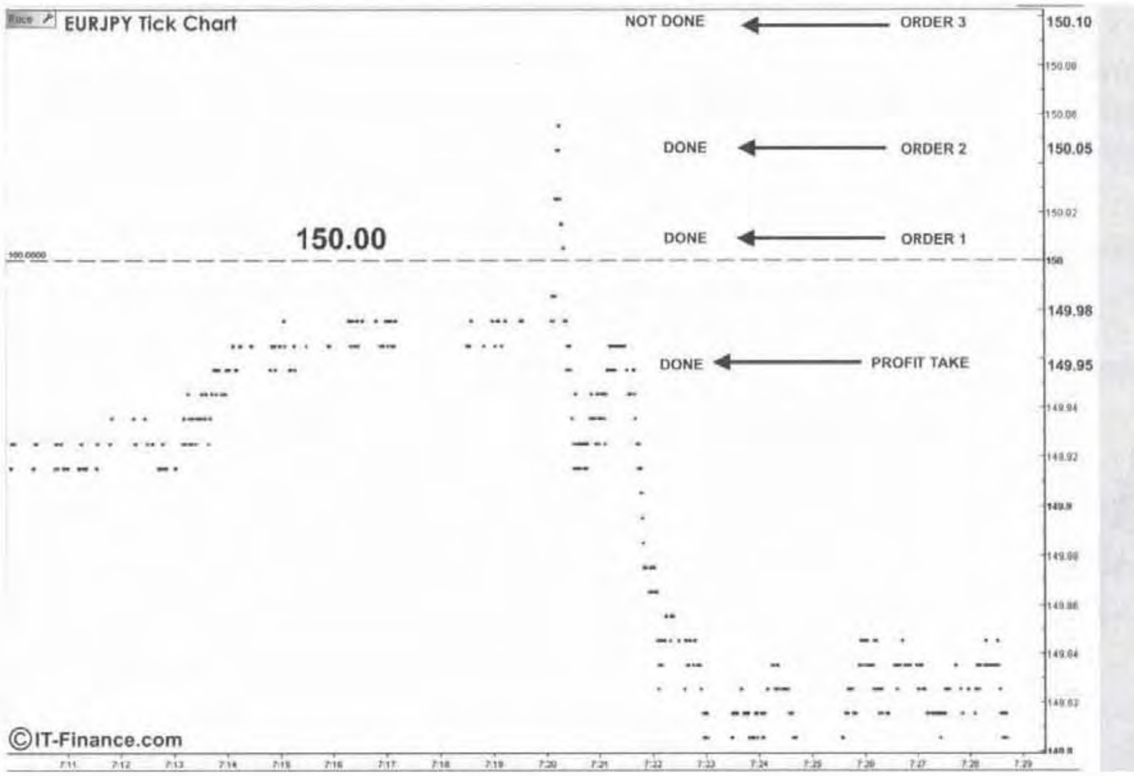
Set your orders beforehand to profit from the quick move.

Step 2. Set Your Orders

Sell 1 at the figure, sell 2 at 5 pips over the figure, sell 3 at 10 pips over the figure. Stops for all are set at 20 over the figure, with a profit take for two-thirds at 5 pips below the figure. If all goes well, you should be short a total of 6 at 150.06 (position size will vary according to your account). Risk for this trade is 14 pips. Profit take is 11 pips.

Wait a minute! What happened to the money management that I have been preaching all along? Is it completely out of whack on this trade? Not exactly.

Because of high probability of this trade working out in your favor, it is better to take the quick profit than risk losing it all by waiting for a deeper correction. We know the price action (spike higher to trip stops, then a quick decline), and that is what we are trying to exploit. Remember that we are trying to take advantage of the dealer's actions, not predict the future. The last third is left on the table in case you did happen to pick the top, although more often than not the rate will continue in the prevailing direction.

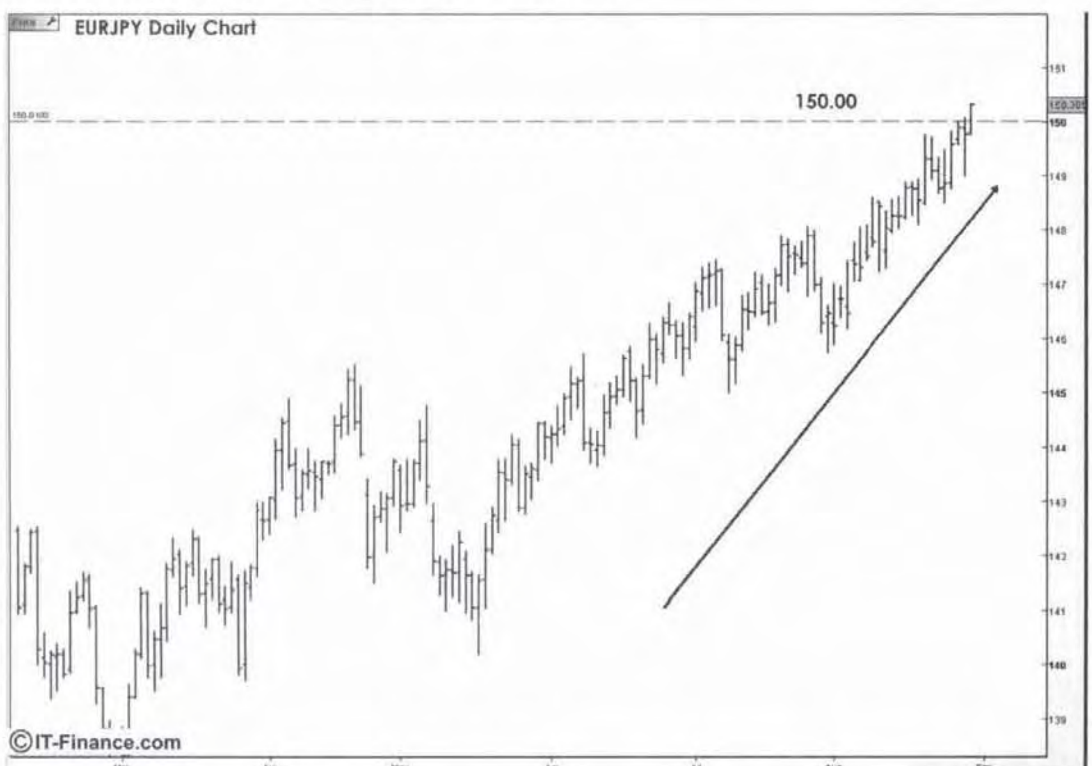


The aftermath: price action is typical. Dealers make a quick move beyond 150, stops go off, and the price trades briefly over 150 (only a couple of ticks) to print a high of 150.06. We only get filled on 2 out of our 3, and the price quickly drops under the big figure. Our profit take at 149.95 is then executed for a quick profit. Not bad for ten seconds of work!

KEYS TO THE TRADE

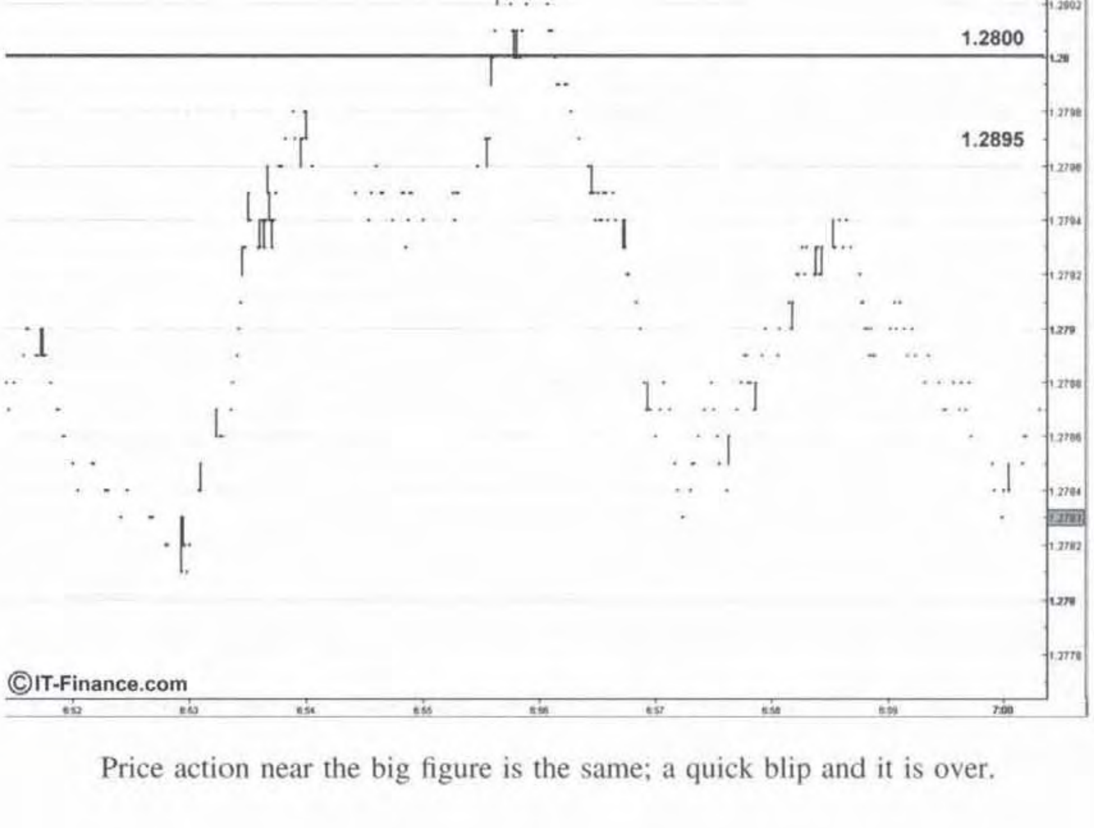
- Be prepared ahead of time and stay vigilant. If the trade does not work out immediately (maximum 15 min) then get out. The price action is telling you that the move is supported by real-money demand, not just dealer initiated.
- Although the moves are similar near most round numbers, this trade works best at the end of an O/B intra-day trending move, coupled with psychological numbers like 1.20, 150.00, 2.00, etc.

This time we get lucky and the rate slumps well below our profit target. Holding on to that last third lets you take advantage of these situations.



The trend is still definitely up (below), so do not even think about fading the move higher. All that we were looking for was a quick, easy trade.

A Big Figure Trade example on EURUSD. Notice the run-up to 1.28.



Price action near the big figure is the same; a quick blip and it is over.

Big Figure Trade example on USDJPY.

Big Figure Trade opportunities within the greater trend.

Close but no cigar!

- Remember that we are not here to predict the future (reversal or continuation?); we are simply riding the dealer's coat-tails. It might continue higher for another 50 pips; it might top-out and collapse. Either way we do not care; we are in it for the low-risk 10–15 pips that the dealers are generous enough to cough up for us.
- Generally, we only want to trade the first stab above the big figure, since that is the one hiding the stops.