HowToTrade

BREAK OF STRUCTURE IN FOREX TRADING [PDF]

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Break of Structure in Forex Trading

Most profitable forex market traders and professionals have built systems around the mantra, "follow the trend."

But it's easy to tell that a market is trending when there's a noticeable rise or fall in the price. However, the market doesn't always move in apparent trends. In fact, the price only moves in clear directions 25% of the time. The remaining 75% of the time, it's either ranging or giving off "hard-to-deduce" trends.

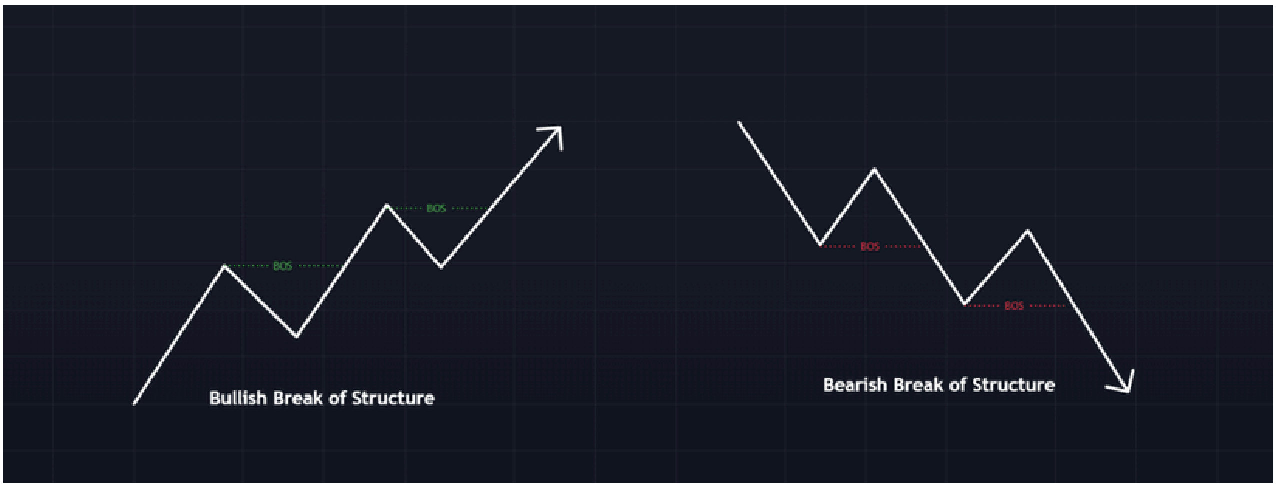
Thankfully, there's one sure way to identify trends. It's a mechanical model that doesn't require indicators or trader discretion. It's called a Break of Structure (BOS).

What is the Break of Structure in Trading?

Typically, the market trends are in steps. It doesn't just go straight upwards or downwards forever. Instead, it moves in waves of upward and downward movements. Uptrends, downtrends, and consolidations only result from the market moving in these price waves of upward and downward movements.

So, naturally, we have a series of higher highs and higher lows in an uptrend and a series of lower lows and lower highs in a downtrend. This is called market structure. But what happens when this structure is breaking?

A break of structure is simply the process of forming a higher high on an uptrend without first creating a lower low; and a lower low on a downtrend without first developing a higher high. In other words, market structure breaks are a change in price behavior and signal a shift in market momentum.



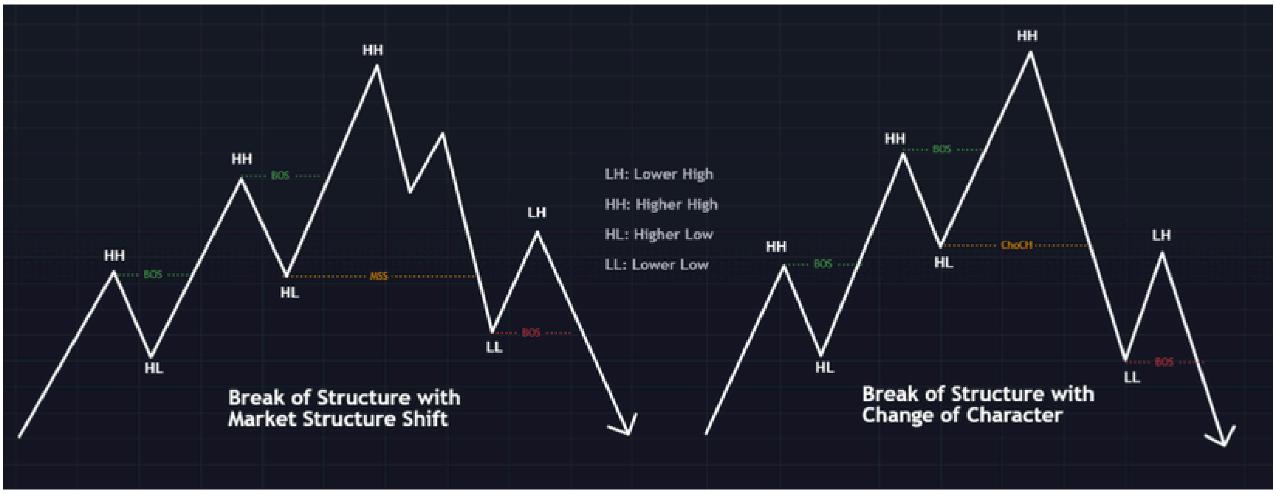
The order is important. It's a break of structure (BOS) only when a higher high is formed on an uptrend without first breaking the low. In a downtrend, it is only a break of structure when the price forms a lower low before breaking its most recent high. If any of those two scenarios happens, we're looking at a Market Structure Shift (MSS) or a Change of Character (ChoCh).

Essentially, a break in structure means that you get the first signal that the existing trend is weakening and a reversal is about to occur.

Market Structure Shift Vs. Change of Character Vs. Break of Structure

Using the smart money concept strategy, you must learn how to differentiate its elements. A Market Structure Shift (MSS) happens when the price breaks the most recent low in an uptrend without first breaking the most recent high.

This is often a sign of a trend reversal. In a downtrend, a market structure shift occurs when the price breaks the most recent high in a reversal without first breaking the most recent swing low. It's in the name: the market structure has shifted.



A change of character (ChoCh) is a slight modification of the Market Structure Shift in that the highs are broken before the price reverses to take the low in an uptrend. For a downtrend, the swing low is taken before the reversal to take the swing high as well.

Before we move on to the next level, it is important to note that it is not a break of structure if the break above the swing point is only a wick instead of the body of the candlestick.

Identifying the Break of Structure – Tools and Techniques

Now that you know what a break of structure is, what's left is to understand how to identify it. Like many other chart patterns and technical analysis indicators, only when you can identify it, will you learn how to trade it. The following tools and techniques will help you spot a break of structure.

1. Fibonacci Support and Resistance Levels

The Fibonacci retracement tool is excellent for helping you spot a break of structure on your price chart.

To use it, all you have to do is to spot your most recent swing high and most recent swing low. If you're on TradingView, draw your Fib tool from the first swing to the other. So, in a bullish swing, you draw your Fib from your swing low to the swing high. And in a bearish trend, your swing low is the origin of your Fib tool.

Here's what it looks like on a price chart:

In a bullish market, you have a BOS if the price breaks above the most recent point of contact on the channel's upper boundary. And if the price breaks below the most recent point of contact with the channel's lower border, you have a bearish market structure break.

The great thing about using trend channels to identify your break of structures is that they are great at filtering out smaller structures so that you can concentrate on the big picture in your timeframe.

2. Trend Lines and Trend Channels

Trend lines and trend channels are especially great tools in helping you identify breaks of structure. Here's how you can use any of them:

You first want to mark out the price's most recent points of contact with your trend channel on both sides.

In a bullish market, you have a BOS if the price breaks above the most recent point of contact on the channel's upper boundary. And if the price breaks below the most recent point of contact with the channel's lower border, you have a break of structure.

The great thing about using trend channels to identify your break of structures is that they are great at filtering out smaller structures so that you can concentrate on the big picture in your timeframe.

3. Break of Structure Indicators

You can also use indicators to spot your break of structures. This is the easiest way. A perfect example of a break of structure indicator is the "MTF Break of Structure (BOS) & Market Structure Shift (MSS)" indicator on TradingView, which was developed by Lenny_Kiruthu.

In addition, you can use other trend momentum indicators to identify the break of structure. Those include the Shcaff Trend Cycle indicator, the Stochastic RSI indicator, and the Detrended Price Oscillator indicator.

The Break of Structure Trading Strategy – How to Trade a BOS

As mentioned, the first thing you need to do is to identify your break of structure. Using any of the methods we described above, identifying your break of structure should be straightforward. Once you can do this, you can look for a trade setup.

1. Trade Setup

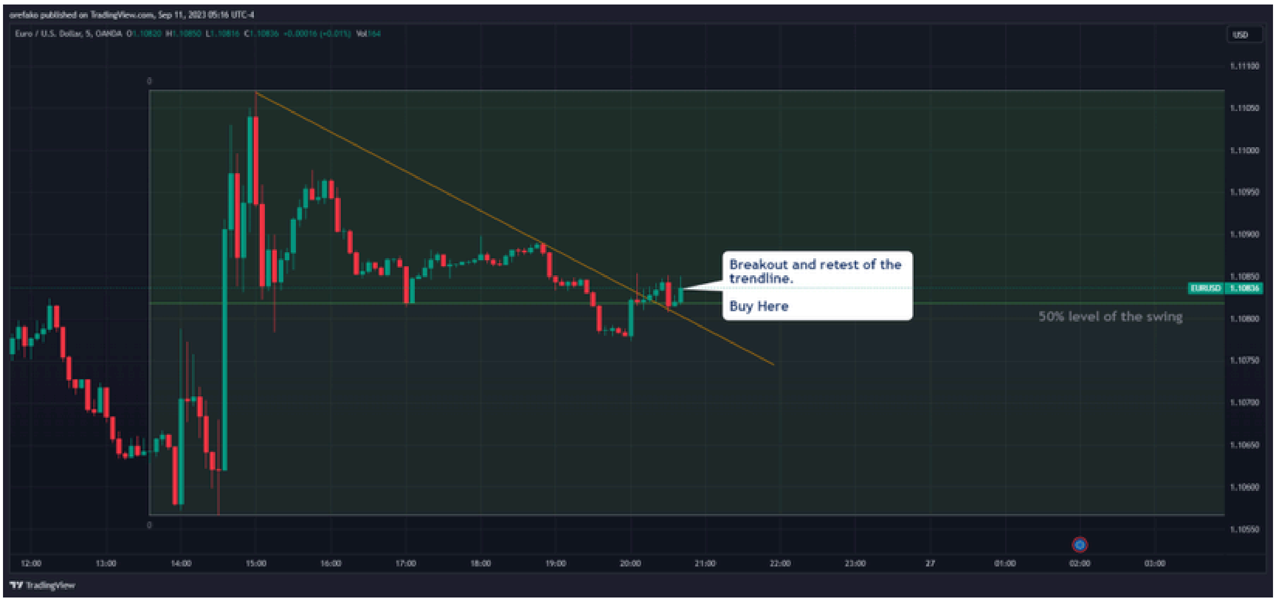
First, wait for the price to make a pullback after a broken structure. Such pullbacks offer trading opportunities to enter the market and ride the market structure break. You don't take any kind of pullback, though. Instead, you only trade those that have pulled back by at least half of the most recent swing.

For a finer entry, try to identify these breaks of structure and their pullbacks on higher timeframe charts. This way, you can pick out your entry to a lower timeframe.

We have a market structure shift in the example of the EURUSD on the 1hr above. Price breaks structure to the upside, and we now have a pullback below the 50% level. Now, we can scout for entries.

2. Trade Entry

At this point, you should delve into a smaller timeframe. Identify any pattern that may suggest a reversal in the direction of your higher timeframe break of structure.



Following our example, we're delving into the 5 mins chart. You'll see that the price first embarks on a series of minor breaks of structure while forming a bearish trendline. The break of that trendline is a great trade entry spot.

3. Stop Loss

Your stop loss should always be beneath the most recent swing high or swing low on your smaller timeframe since that's where you're getting your entry.

4. Take Profit

Your first take profit target should be at the same level as the swing that led to your pullback on the higher timeframe. So, if you're looking to take a bullish trade, your first TP should be at the same level as the swing high on the higher timeframe. And if you're in a bearish trade, your target is the most recent swing low on the higher timeframe.

However, because we expect the newly formed structure to break, you could even set your take-profit targets above or beneath your swing high and swing low, respectively. Just don’t forget to use proper risk management.