SMART MONEY CONCEPT TRADING STRATEGY [PDF]

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Smart Money Concept (SMC) Trading Strategy

The Smart Money Concept strategy has gained viral attention over the past few years, and it's mostly for good reasons: it seems to be working. At least for some people. But what's unique about this SMC strategy, anyway?

The SMC is not a strategy, per se. But it's more of a theory or philosophy. You'll see how that is in the rest of this SMC trading strategy pdf.

What is the Smart Money Concept in Trading?

Smart Money is all about supply, demand, and market structure. Market makers, or the "smart money," often leave footprints of their trading decisions on the chart, and smart money concept traders are to follow these footprints.

Retail traders tend to believe the financial market (especially the forex market) is fair for them to make money, but the SMC might prove otherwise. Here's how the theory goes:

The Role of Market Makers.

Market makers such as banks, hedge funds, and other prominent market participants who can move substantial amounts of capital can allegedly manipulate the market against retail traders. While this may sound like a conspiracy theory, it is worth looking into.

These institutions are in the business of making profits or supplying the needs of a country or a big corporation. They are not shy about using their vast resources and market knowledge to their advantage, including setting traps for retail traders to part with their money.

The Reaction of Retail Traders

Retail traders, often ignorant of these activities, are more likely to fall victim to the market's unpredictable swings.

However, that's not the entire idea of SMC. Very often, these big players enter the market with good intentions. For instance, a government that must purchase large quantities of a commodity, such as wheat, soybeans, or crude oil, can obviously push prices in a specific direction.

So, based on the SMC theory, financial markets are largely controlled by financial institutions, hedge funds, and governments. They significantly impact price movements in the market, and therefore, retail traders must be alert to their intentions to predict where the market is heading.

That, in a nutshell, is what the SMC is all about. If you believe in smart money concepts trading, then you, as an individual trader, should follow smart money.

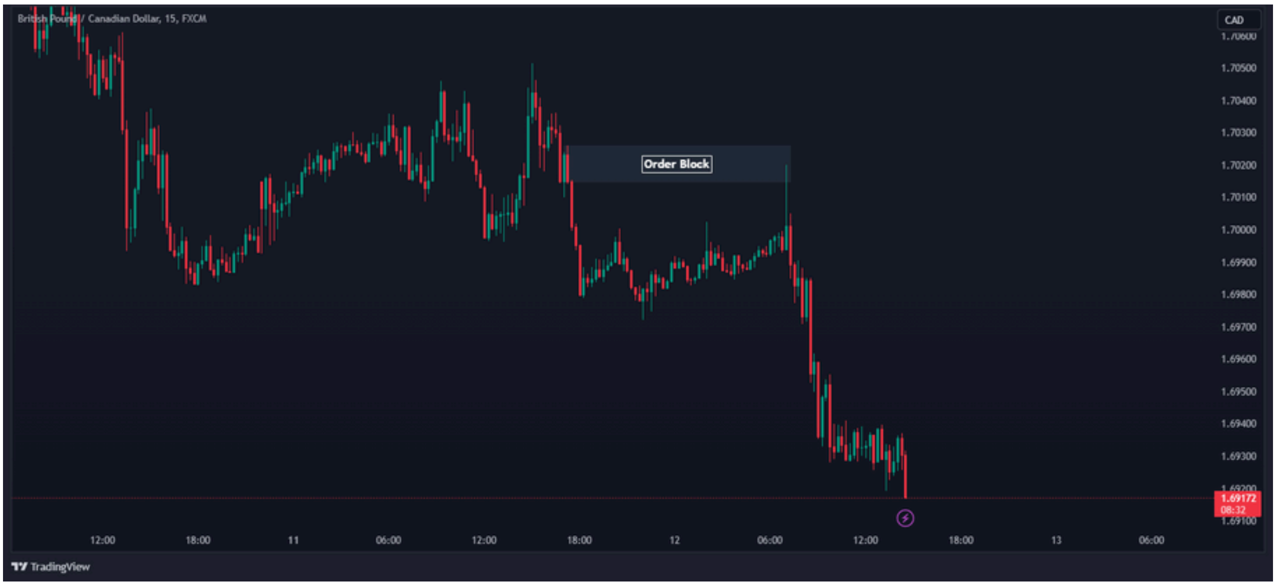
SMC Key Concepts

Rather than being just a theory, SMC is a complete trading methodology with its unique terminologies and concepts. Let's take a closer look at some of SMC's concepts and trading techniques.

1. Order Blocks (OB)

This concept is fundamental to understanding SMC. Essentially, order blocks refer to a market condition when central banks, governments, and large financial institutions accumulate or distribute large quantities of an asset through several big orders. They do so to be able to purchase the asset without creating panic and high volatility in the market.

On a price chart, order blocks typically appear as a ranging market (as seen in the chart below). However, to properly identify order blocks in the market, you must use additional tools, such as level 2 market data and volume indicators.



2. Breaker Blocks

These are order blocks that fail to hold the price level in a given trend. They represent price levels where market makers intentionally break through support or resistance levels to trigger stop-loss orders from retail traders.

3. Fair Value Gaps (FVG)

Fair value gaps, also referred to as FVGs, are a unique trading concept that occurs when the market moves quickly from one price level to another, often leaving gaps on price charts. SMC traders pay close attention to these gaps as they can indicate significant shifts in market sentiment.

4. Break of Structure (BOS)

The break of structure is a concept that focuses on identifying shifts in the market's overall trend. A break of structure is said to have taken place when the price sets a new high or a new low while breaking the former ones.

5. Change of Character (Choch)

Change of Character, often abbreviated as Choch, refers to a situation where the market’s behavior shifts abruptly. It is a sudden change in volatility, volume, or price action, suggesting a weakness in the current trend and a possible reversal.

6. Liquidity

Liquidity is a crucial factor in SMC trading. It is a point in the price of an asset where orders are either sitting above or below, waiting to be collected. There are different types of liquidity, e.g., trendline liquidity, buy-side liquidity, sell-side liquidity, double tops, and double bottoms, etc.

How to Trade with the Smart Money Concept Trading Strategy

There are different ways to trade the smart money concept strategy. While some professional traders may be obsessed with a complicated approach, here's a more straightforward but effective way to trade SMC:

Step 1: Determine the Trend

The first thing you need to do when trading the SMC is to identify the primary trend. In SMC trading, determining the trend is based on a sound understanding of market structure. If this analysis is done correctly, we will often find trades on the right side of the market.

As we've mentioned, we are in a downtrend when the price breaks structure to the downside, forming a series of lower highs and lower lows. Conversely, a series of higher highs and higher lows signify an uptrend. Similarly, a change of character (Choch) signals the change of a trend.

The chart above shows that the trend has changed from bearish to bullish after the change of character. This means we are no longer looking to sell this pair. Instead, we want to buy when our entry criteria appear on the chart.

Step 2: Identify High Probability Order Block

After determining the trend, we are only concerned with identifying where the market makers are preparing to execute their orders and ride along, and this is where identifying the best order block is crucial.

In our example, we can see a sell-side liquidity building under the first order block. Although it broke the market structure to the upside, there is also a fair valued gap directly under the supply and demand zone. We expect the market makers to take this liquidity out before continuing the uptrend.

The order zone below the liquidity is our high probability bullish order block for various reasons: it causes a CHoCH to the upside and has a liquidity and fair value gap just above it. We expect prices to come to this zone and continue the uptrend.

Step 3: Determine Your Entry and Exit Points

Next, you must identify areas where the big players enter the market. Identifying entry and exit points becomes easy after detecting a valuable supply or demand zone. For our illustration, we will place our entry just above the bullish order block while setting our stop loss just below the zone, and the target profit will be set to the structural high.

Smart Money Concept vs Price Action – What's the Difference?

We have established that the smart money concept strategy is built on solid price action methodologies. Indeed, the smart money concept and price action trading have many similarities. Some might even claim that both are the same.
However, they are still different in the following ways:

1. Interpretation of Market Dynamics

The most important of all is how each method aims to interpret market dynamics. Price Action traders are primarily technical traders who seek to identify trends, reversals, and trading patterns that suggest potential price movements. They may not be as concerned with why these movements occur as long as they can make accurate predictions based on historical price data. They look at charts and rely on charts. Most of the time, they do not try to understand the reason why an asset moves in a particular direction.

SMC traders, on the other hand, are deeply interested in the underlying forces that drive price movements. They seek to understand the intentions of market makers and how supply and demand dynamics influence price. The core idea of the SMC theory is that instead of looking at the chart, SMC traders try to identify where the smart money goes. That's the main goal of the SMC strategy – that is, to follow the money.

2. Approach to Market Analysis

Price Action traders primarily rely on technical analysis tools, including candlestick patterns, indicators, and support and resistance levels, to make trading decisions. They pay close attention to how price moves and use historical price data to identify potential trade setups.

SMC traders, meanwhile, look beyond price patterns. They analyze order blocks and breaker blocks to gauge the intentions of institutional players. SMC traders are more concerned with why prices move the way they do, which often involves understanding the activities of market makers.

3. Terminology

Price Action trading relies on a relatively straightforward set of terms and concepts, making it accessible to traders of all levels. It involves terms like doji, hammer, double top, or the Non-Farm Payrolls – all widely recognized in the trading community.
SMC introduces a unique vocabulary, including "liquidity grabs" and "mitigation blocks." These terms may sound unfamiliar to traders who are not well-versed in the SMC strategy.

Is the SMC a Good or a Bad Trading Method?

Generally, opinions vary widely regarding the effectiveness of the Smart Money Concept (SMC). Some traders swear by it, while others remain skeptical. Still, here's all the information you need to choose which side you're on:

Pros

- SMC Does Seem to Work for Some Traders: The Smart Money Concept has proven to be a valuable tool for many traders. It provides a unique perspective on market dynamics, helping traders make informed decisions. Those who have found success with SMC argue that if it works for them, and there's no reason not to use it. They appreciate its focus on understanding the intentions of institutional players and believe it enhances their trading acumen.

- SMC as a Repackaged Price Action: One argument favoring SMC is that it repackages price action trading, which has a long history of producing positive results. Price action, which analyzes price movements and patterns without relying on the smart money concept, has been embraced by traders across various assets, including currencies, stocks, and commodities. Since SMC is built upon these core price action principles, supporters see it as a strategy with a solid foundation that aims to be an improvement of the price action trading method.

- Enhanced Understanding through SMC: Some traders find that SMC provides a clearer, more structured way to understand price action and markets dynamic. The unique terminology used in SMC can simplify complex concepts for those who resonate with this approach. It offers traders a fresh perspective and a new lens through which to view the market.

Cons

- The Lack of Concrete Evidence: Critics of the Smart Money Concept raise valid concerns about its validity as a trading strategy. While SMC traders assert that market manipulations by “smart money” players are responsible for certain SMC patterns, there is a notable absence of concrete evidence to support these claims. Skeptics argue that without verifiable proof of such manipulations, accepting SMC as a reliable strategy is challenging.

- The Significance of Retail Trader Liquidity: Another point of contention revolves around the role of retail traders in the market. SMC suggests that “smart money” hunts for liquidity provided by retail traders. However, skeptics argue that the liquidity contributed by retail traders is relatively insignificant in the grand scheme of things. Market makers, the alleged manipulators, have access to vast pools of capital, making it unlikely that they would target small retail traders.

- Complicated Terminology for Beginners: The unique terminology used in SMC can be overwhelming for newcomers to the trading industry. Skeptics argue that simpler terminology would make forex trading strategies more accessible to a broader audience and reduce confusion among new traders.

Overall, whether you agree with the Smart Money Concept theory or not, one thing is clear: the strategy works. At least for some traders. While learning the concept might seem challenging for new traders, understanding the smart money theory creates the right context that shortens this learning curve. That is especially the case if you believe in the notion that large financial institutions, governments, and central banks are those who control the markets.