Smart Money Concepts (SMC): A Practical, Exam-Ready Guide with Examples

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Audience: Intermediate-to-Advanced Traders, Quant/ML Engineers exploring price-action execution models.

Table of Contents

1. What is SMC?

Smart Money Concepts (SMC) is an umbrella term for institutional price■action theory that emphasizes market structure, liquidity engineering, and imbalances to anticipate where price is likely to move next. Rather than chasing indicators, SMC focuses on how large participants (the “smart money”) leave footprints—e.g., liquidity grabs above equal highs, or displacement candles that create price imbalances—and how the market later mitigates those footprints (e.g., returning to an order block). SMC is not one single rulebook; it’s a framework. You can formalize it into repeatable rules to generate signals and then validate it with statistics or ML.

2. Core Principles

- Price seeks liquidity: pools rest above equal highs and below equal lows.
- Trend (market structure) first; setups come second.
- Displacement creates inefficiency (imbalance/FVG); price often rebalances later.
- Order blocks (the last up/down candle before a strong move) are probable reaction zones.
- Refine entries on lower timeframes; manage risk around liquidity.

3. Market Structure: HH/HL/LH/LL; BOS vs CHOCH

Higher High (HH), Higher Low (HL), Lower High (LH), Lower Low (LL): Track swings to identify bullish or bearish structure. BOS (Break of Structure): Continuation signal—price breaks a key swing in the trend direction (e.g., breaks a prior HH in an uptrend). CHOCH (Change of Character): Early reversal hint—price breaks a swing against the prevailing structure (e.g., breaks a prior HL in an uptrend). Practical tips: • Use clear swing points (avoid minor noise). • Anchor structure on your higher■timeframe (e.g., Daily/4H), then refine on execution timeframe (e.g., 15m/5m).

4. Liquidity & Inducements

External liquidity typically sits above obvious swing highs or below swing lows; internal liquidity forms inside ranges (e.g., equal highs/lows within consolidation). An inducement is a nearby swing formed just in front of a key zone that entices early entries; price may sweep this inducement before the real move. Look for: equal highs/lows, trendline taps, session highs/lows, round numbers, previous day/week highs/lows.

5. Imbalance / Fair Value Gap (FVG)

An Imbalance / Fair Value Gap (FVG) occurs when a fast move leaves a price void (e.g., in a 3■candle sequence, the middle candle’s body/wick doesn’t fully overlap the prior/next). Markets often retrace into the FVG to rebalance before continuing. FVGs near structure/OBs are higher■probability.

6. Order Blocks (OBs) & Mitigation

An Order Block (OB) is the last bearish candle before a strong bullish displacement (for longs) or the last bullish candle before a strong bearish displacement (for shorts). The mitigation of this candle (often its open or a 50% level) can serve as an entry zone, especially when aligned with market structure, liquidity, and FVG. Refinement ideas: • Require a BOS after the OB forms to confirm intent. • Prefer OBs that cause clean displacement and leave an FVG. • Use lower■timeframe confirmation (e.g., CHOCH into OB).

7. Premium/Discount (Dealing Ranges)

Define a dealing range using a swing low and swing high. Above the 50% midpoint is premium (expensive for longs), below is discount (attractive for longs). In bearish contexts, short from premium; in bullish contexts, buy from discount. This aligns entries with value zones.

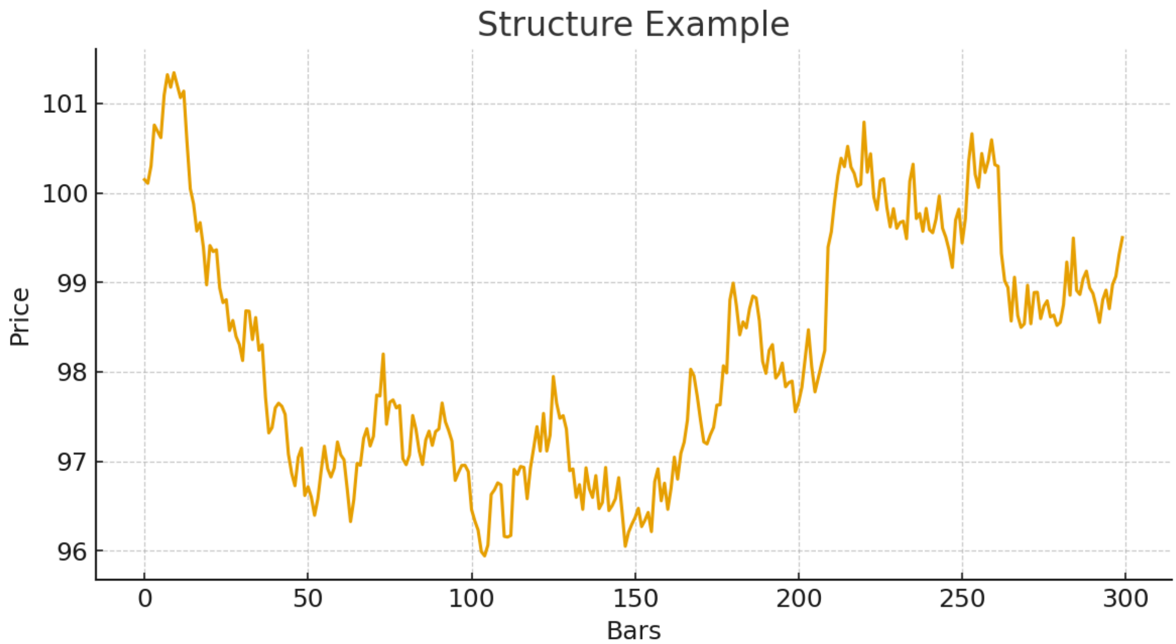

Figure 1: Structure, BOS/CHOCH, OB, and an example FVG on a synthetic series.

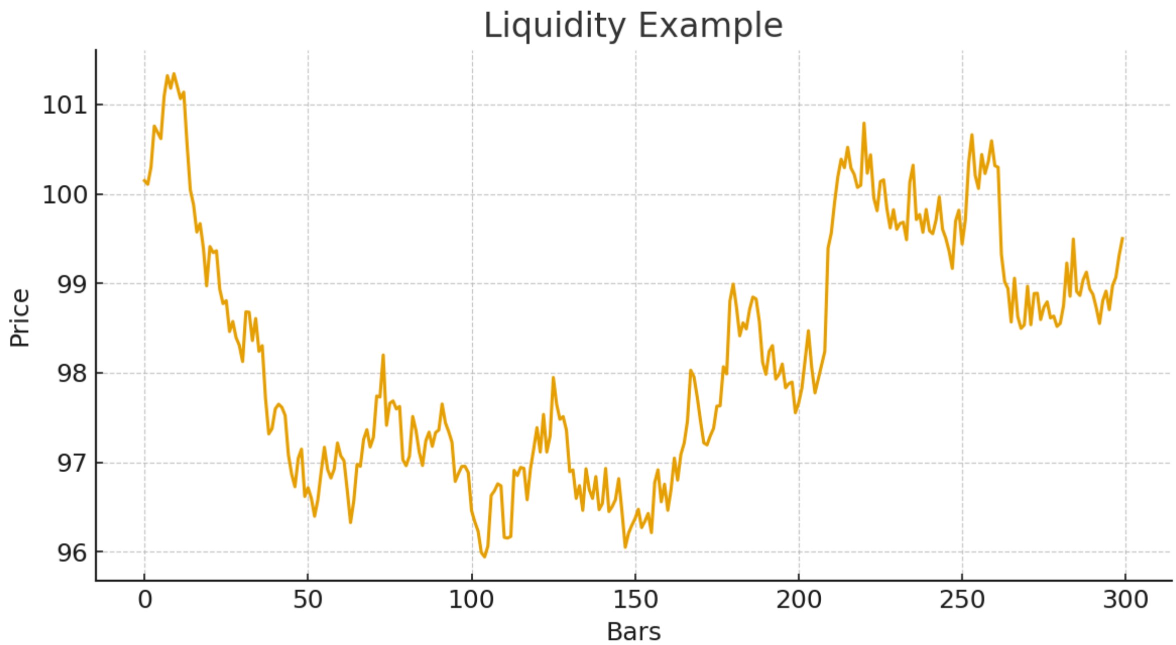

Figure 2: Equal highs (liquidity) and a sweep before reversal.

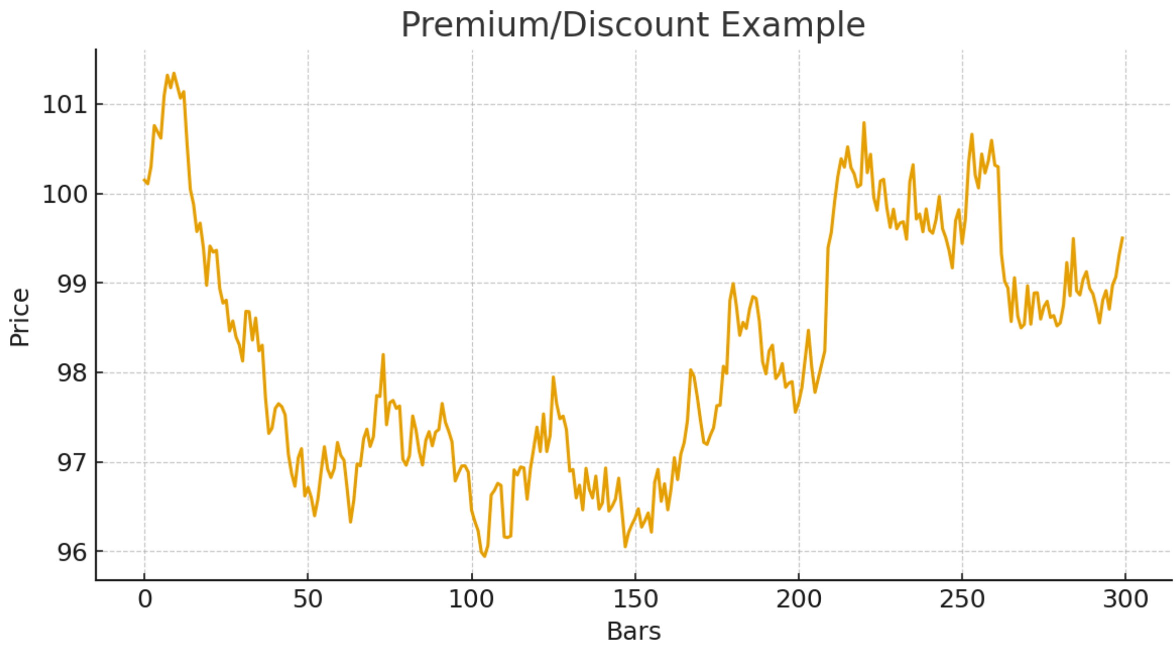

Figure 3: Premium/Discount within a defined dealing range.

8. Multi■Timeframe Top■Down Process

A robust SMC workflow is top■down: 1) Higher■Timeframe (HTF, e.g., Daily/4H): Determine directional bias via structure and key liquidity (prior highs/lows). Mark HTF OBs and FVGs. 2) Mid■Timeframe (MTF, e.g., 1H/30m): Refine zones, find confluences, and plan scenarios (pro/anti■trend). 3) Execution Timeframe (e.g., 15m/5m/1m): Wait for confirmation—e.g., liquidity sweep into your zone + CHOCH + displacement, then enter on mitigation.

9. Execution: Entry Triggers & Trade Management

Entry triggers (example long model): • HTF bias bullish; price trades into discount of the dealing range. • Liquidity sweep below a recent low (inducement taken). • Bullish CHOCH on execution timeframe; displacement candle leaves FVG. • Price mitigates a small bullish OB inside the FVG; enter on mitigation/limit at OB open/50%. • Stop: below the swing low/OB; First targets: liquidity above recent highs, partials at 1R/2R. Trade management: • Scale out at logical liquidity/imbalances. • Move stop to breakeven after 1R or after BOS in your favor. • Avoid trades into opposing HTF OB/FVG unless scalping.

10. Full Long & Short Walk■Through (with Charts)

Long Example (Step■by■Step): 1. HTF shows bullish structure with a clear BOS to the upside. You mark the swing low (discount boundary) and swing high (premium boundary). 2. Price retraces into discount and prints an equal■lows cluster (internal liquidity). 3. A sweep dips below the cluster, immediately followed by a strong bullish displacement candle that leaves an FVG. 4. The last down■candle before the displacement is your bullish OB. 5. Wait for price to retrace into the FVG/OB. On the execution timeframe, a small CHOCH confirms buyers. 6. Enter on mitigation with stop below the sweep low. Targets: internal highs first, then the external swing high. Short Example (Step■by■Step): 1. HTF flips bearish with a clear CHOCH and subsequent BOS down. 2. A set of equal highs forms just below a prior HTF bearish OB—liquidity resting above. 3. Price sweeps the equal highs into the HTF OB, then prints a bearish displacement leaving an FVG. 4. Identify the last up■candle before the drop (bearish OB). 5. Wait for a retrace into the FVG/OB; on the execution timeframe, look for a bearish CHOCH to enter short. 6. Stop above the sweep high; targets at internal lows, then external swing low.

11. Risk Management & Position Sizing

Position sizing (fixed fractional): R = percentage of equity you're willing to risk per trade (e.g., 0.5%–1%). Position size = (R × Account Equity) / Stop Distance (in price units) × (Contract Multiplier if applicable). Other tips: • Skip trades if HTF/MTF context is unclear. • Avoid stacking risk on correlated pairs/stocks. • Track metrics: win rate, avg R, max drawdown, time■in■trade.

12. Example Rule■Set & Backtest Pseudocode

Below is a compact, language■agnostic pseudocode for turning SMC logic into rules that can be backtested:

```
# Pseudocode for a simple SMC filter (daily data, long-bias example) for each instrument:
# 1) Structure Bias (HTF) if BOS_up and price_in_discount_of_HTF_range: bias = "bullish"
else: continue # 2) Liquidity Event (Execution TF) if swept_prior_internal_low and
immediate_displacement_up and FVG_present: # 3) OB Mitigation Entry entry =
OB_open_or_midpoint stop = recent_sweep_low tp1 = internal_high tp2 = external_swing_high
if risk_to_reward(entry, stop, tp1) >= 1.5: place_order(entry, stop, tp1, tp2)
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13. Checklist & Common Mistakes

Pre■trade checklist:

- Is the HTF bias clear (trend + key liquidity map)?
- Are you trading from discount (long) or premium (short)?
- Was there a sweep/inducement into your zone?
- Did a clear displacement leave an FVG?
- Is your OB fresh and causative (led to BOS)?
- Confirmation on execution TF (CHOCH/BOS)?
- Defined stop (below/above the sweep) and realistic targets (liquidity)?
- Risk capped, no overlap with correlated exposure.

Common mistakes to avoid:

- Forcing trades in chop; ignoring HTF context.
- Entering at mid■range with poor R:R.
- Treating every candle as an OB; missing displacement.
- No validation (CHOCH) on execution timeframe.
- Overfitting lines; not tracking stats or expectancy.

14. Glossary

Term	Meaning
BOS	Break of Structure; continuation break in trend direction.
CHOCH	Change of Character; first meaningful break against prior structure.
Liquidity	Resting orders commonly found above equal highs/below equal lows.
Sweep	A quick run through liquidity followed by rejection/reversal.
FVG	Fair Value Gap / Imbalance left by displacement that may be rebalanced.
Order Block (OB)	Origin candle of a move that causes displacement; mitigation zone.
Premium/Discount	Dealing range halves: premium (upper 50%) and discount (lower 50%).

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