
THE DO'S AND DON'TS OF TRADING ETFS

Paige Corbin — Capital Markets Associate

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Exchange-traded funds (ETFs) have seen immense growth over the past decade. There are a [multitude of benefits](#), including transparency, tax efficiency and the ability to make intraday trades, that have contributed to the use and growth of ETFs. While these are all beneficial to investors, we continue to see questions around ETF trading. Although ETFs do trade on-exchange like stocks, investors have to understand that ETFs trade differently and that ETF execution is an imperative part of investing that should not be minimized.

Many investors know that when evaluating an ETF, [average daily volume \(ADV\) does not indicate the true liquidity of an ETF](#). The [liquidity](#) of an ETF resides in its underlying securities, but how does one access that to ensure smooth execution?

Let's discuss the do's and the don'ts of how to best trade an ETF.

The Don'ts

1. Don't trade in the first or last 15 minutes of the trading day. This is when trade desks have less transparency and markets are more [volatile](#).
2. Don't place [market orders](#); if you want to trade electronically, place [limit orders](#). We advise investors to always use limit orders, especially in times of volatility. We also advise investors to not use [stop-loss](#) orders that turn into market orders.

The second point is especially important to focus on because many investors can make costly mistakes by simply "throwing in a market order." Let's take a look at an example that illustrates this point.

Figure 1



Source: Bloomberg, as of 6/20/18.

Figure 1 shows an investor who wanted to purchase The [WisdomTree Bloomberg Floating Rate Treasury Fund \(USFR\)](#). Instead of utilizing his or her resources and working with a trading desk, he or she carelessly entered in a market order that spiked the graph up nearly 11%. That is an extremely costly mistake that he or she will have to share with clients. The underlying securities are [U.S. Treasury floating rate notes](#), which are extremely liquid, with an outstanding issuance of \$342 billion as of May 31, 2018.¹

The Do's

1. Do utilize your resources. Consult your trading desk as well as the relevant capital markets desk. The majority of issuers have capital markets teams that can consult on a trade. Additionally, the majority of advisors have access to a trading desk. These desks have access to expert [market makers](#) who can access the underlying liquidity, just like the example in figure 2.
2. Do use a limit order when trading electronically, this cannot be said enough!

Figure 2

USFR trading_DO

The client in figure 2 was able to trade 811,192 shares or just over \$20 million notional at a penny inside the offer. That is 30 times the ADV at the time of the trade! The investor worked with his or her trading desk because they knew that there was plenty of liquidity available via the underlying securities. Making a simple phone call or sending a simple email can make the world of a difference. Would you rather be the investor who spiked the graph up 11% or would you rather be the investor with flawless execution?

The [WisdomTree Capital Markets](#) desk is always a resource in terms of ETF trading and education. Any question is valid and no order size is too small to reach out to us for a consultation. Most investors have a trading desk through their firm or custodian, and they are always a resource as well. If there is one thing to take away from this piece, it's do use your resources and make that phone call or email—it can be the difference between seamless execution and a very costly mistake.

¹Source: U.S. Treasury Monthly Statement, as of 5/31/2018. <https://treasurydirect.gov/govt/reports/pd/mspd/2018/opdm052018.pdf>

Important Risks Related to this Article

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DEFINITIONS

Average daily volume : Average dollar amount traded over the course of a single trading day.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Market Orders : An order that an investor makes through a broker or brokerage service to buy or sell an investment immediately at the best available current price.

Limit Orders : An order placed with a brokerage to buy or sell a set number of shares at a specified price or better.

Stop-loss market orders : an order whereby the investor instructs the broker to automatically sell the stock if it drops to a certain price.

Floating Rate Treasury Note : a debt instrument issued by the U.S. government whose coupon payments are linked to the 13-week Treasury bill auction rate.

Market maker : Someone who quotes a buy and a sell price in a financial instrument.