ARE YOU NEGOTIATING YOUR ETF TRADING PRICES?

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The content of this post is relevant to institutional investors interested in trading ETFs in significant size. Individual investors do not have access to liquidity providers to trade ETFs, regardless of volume, as referenced in the content below.

It's surprising to me how many investors in significantly sized blocks of ETFs agree to trade at whatever price is offered to them. Essentially, it's the equivalent to walking into a car dealership, without doing any price research, and paying sticker price. However, like a car dealership, the block trading market in ETFs, where liquidity providers make markets in large size to the advisor community, is a negotiable marketplace.

It's important to clarify that I'm focusing on large trades, typically blocks of more than 5,000 or 10,000 shares. In smaller-size trades (5,000 shares or fewer), order flow typically interacts with order flow electronically and trades are filled (or not) based on supply and demand. However, in large block trades, investors are often trading against an ETF liquidity provider, usually by phone. In this case, if you have a block of ETF shares to execute, in many ETFs you would be well served to call a liquidity provider to get a market in the fund, so you can trade the whole block at once. If you're an advisor, and you work on a platform, your execution desk will likely have contacts at a variety of ETF liquidity providers, and they may call on your behalf to get bids and offers for your block trade. So if you have 25,000 shares to buy in a particular ETF, you can call your execution desk and ask them to get you a "market" in that particular fund. What you are asking is for the execution desk to reach out to a liquidity provider and come back to you with a bid and an offer for 25,000 shares.

The two obvious choices you have when your execution desk comes back with a market are 1) trade at the price offered, or 2) don't trade at the price offered. However, what many investors do not realize is that there is a third option: You can negotiate against the offer. This requires some knowledge about the fair value of the fund and carries the risk, albeit rare, that the given offer may be rescinded. Here's an example: Say, your desk or provider quotes you a market of $50.05 bid and offered at $50.15. You can say, "Ok, I'll buy those," and you will be buying the 25,000 shares at $50.15, or you can say, "No, thanks," and hang up the phone. OR you can say, "I'll pay $50.10 for 25,000 shares." At this point the liquidity provider making the market has a choice: sell to you at the lower level, counteroffer at a level in between (maybe at $50.12) or—and this is the potential risk—move their offer higher. Again, this is rare; if the provider is unwilling to negotiate, they will likely reiterate their first offer.

We recently had a client situation that demonstrated how this process can result in significant cost savings in ETF executions. The client was a buyer of several hundred thousand shares of a WisdomTree ETF. They called their platform execution desk and asked for a market. The desk reached out to a liquidity provider, and the client was shown an offer that was eight cents above the offer quoted on the screen, albeit for a small size. At that moment the difference between the quoted offer and the offer for the larger size seemed too big for the client, so they said, "No, thank you," and then called the WisdomTree capital markets team. We have a strict policy of not getting in the middle of price negotiations between our clients and our liquidity providers. We leave the pricing of funds up to the professionals who are actually going to be offsetting risk, and we respect their judgment tremendously. However, we do perform sanity checks and help clients understand the rationale behind some of the pricing they may be seeing. In this case we advised the client to show a counterbid. The client called back with a slightly lower bid for the shares. The level was acceptable, and the trade was executed at four cents above the quoted offer. (This all happened in the span of two minutes, so the market had not moved.) The client saved approximately $16,000 on the execution and, even more important, felt comfortable with the price they

were paying. And the liquidity provider got to make the sale, which is their goal. Everyone was happy.

Now you can add the price negotiation tool to your own execution tool kit. It's not going to help you all the time, and sometimes it won't be needed at all. But it's a powerful weapon to know that the business of pricing large blocks and the prices those trades take place at are negotiable.

To learn more about WisdomTree and our approach, click here.

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Liquidity providers : Traders that facilitate the trading of ETF shares by conducting the transference of liquidity between the underlying basket shares and the ETF.

Dividend-focused ETFs : ETFs that focus particularly on dividends when screening potential constituents for inclusion.

Bids : What investors are willing to pay.

Offer : The price at which investors are willing to sell.