ETF Know:How

Best practices for trading ETFs

Traditional exchange-traded funds (ETFs) combine the intraday trading of stocks with the diversification of mutual funds to create a potentially lower-cost investment solution that can be a powerful tool in portfolio building. However, even the most seasoned investors should consider several factors when buying and selling ETFs.

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Making the most of ETF trading

ETFs are lauded for their potential cost efficiency. But in reality, getting the best price means considering several factors before executing a trade.

1 Consider the order type

The type of order an investor places can have a big impact on cost.

- **A market order**—an order to buy or sell immediately at the best available price—may lead to less than optimal trade execution.
- **A limit order**, or marketable limit order, allows investors to set the exact price they are willing to pay or receive for an ETF share, but it does not guarantee the full order will be executed—or executed at all if the market moves. This is generally considered to be the preferred order type for trading ETFs.

2 Use caution if trading at market open or close

Bid/ask spreads tend to be wider at market open and close,[1] so investors should keep this in mind when timing their trades. This happens because:

- Not all of an ETF's holdings may be trading at market open, making it difficult for authorized participants (APs)[2] to price ETFs during the first few minutes of the trading day.
- APs begin to balance their books toward market close and may be reluctant to take on large positions.

3 Mind volatile market environments

Investors should take care when trading in volatile market environments because extreme market fluctuations can lead to premiums or discounts to an ETF's net asset value and potentially higher investor costs. They should also keep an eye on earnings reports, general economic releases, Federal Reserve Board announcements, and similar events that may cause a widening of ETF bid/ask spreads.

4 Understand ETF liquidity

An ETF's average daily volume is not its only indicator of liquidity. Investors should also look at the bid/ask spread and the liquidity of the underlying securities to get a better picture of overall liquidity.[3] In addition, they should keep in mind that differences in trading hours for an ETF's underlying securities may lead to diminished liquidity in the ETF.

5 Reach out to a valued broker

ETFs may trade very differently based on the underlying asset class as U.S. equities, international equities, and fixed-income products have distinct, defining characteristics that directly impact pricing. As certain brokers have comparative strengths in the types of ETFs that they specialize in, investors may consider reaching out to an ETF's capital markets and sales team for referrals as to which brokers may have inventory or a differentiated ability to provide a superior trading experience.

Summary

With ETF trading best practices in mind, investors can make more informed trading decisions and potentially use ETFs more effectively in their portfolios.

ETF Know:How

We're always here to help

ETF Know:How is a full-spectrum curriculum of ETF tools, resources, and insights created for all levels of ETF expertise. This educational program offers you a 360-degree view of ETF investing, with tactical steps to help support your business—from client engagement to portfolio implementation.

To learn more about ETF Know:How and how it can help advance your ETF expertise, call 877-824-5615 or visit schwabfunds.com.

Investment returns will fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are not individually redeemable directly with the ETF. Shares of ETFs are bought and sold at market price, which may be higher or lower than the net asset value (NAV).

[1] "Ask" is the price a seller is willing to accept for a security; "bid" is the price a buyer is willing to pay for a security.

[2] Authorized participants are typically large institutional organizations, such as market makers or clearing firms, that are responsible for creating the underlying basket of stocks for an exchange-traded fund (ETF) and/or redeeming ETF shares in the form of a redemption unit.

[3] "Liquidity" is the relative ease with which a security can be bought or sold without impacting its price.

[4] "Intraday indicative value" is an estimated value of holdings based on the most recent prices of the ETF's underlying securities and other assets.

[5] See also "ETF Trading and Liquidity: A Deeper Dive" for more details.

[6] See also "International ETFs and the Price Discovery Mechanism" for more details.

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