Global Asset Management

Five things to know when trading ETFs

ETFs can be an important part of your investment strategy. Here are a few best practices for trading efficiency.

1 Best to use limit orders over market orders

Limit orders enable an investor to set the price at which they want to buy or sell their ETF units, and help to ensure an investor does not pay more or receive less than a predetermined price. Limit orders prioritize price over speed of execution.

In contrast, market orders (the default order at most brokerages) are executed at the prevailing market price. The price received is the 'best available' in the market, however it can change very quickly as market volatility and changes in liquidity can influence the prevailing market price. Market orders prioritize speed of execution over price.

	Pro	Con
Market Order	Order is usually filled quickly	No control over the price at which the order is filled
Limit Order	Control over the price at which the order is filled	Chance the order will not be filled

2 Be careful about trading when the market is volatile

During periods of extreme market volatility and uncertainty, markets can experience significant intra-day swings. Uncertainty can cause bid-ask spreads to widen, potentially detracting from returns (Remember the point above about using limit orders). ETF investors should also be careful to avoid the first and last twenty minutes of the trading day, when the market is often particularly volatile, as settlements and supply adjustments can negatively affect bid-ask spreads.

3 Trade ETFs providing international exposure early in the day

Generally, to minimize volatility, it's better to trade ETFs that provide exposure to international markets when the underlying local markets are open. Because ETF values are based on the prices of their underlying securities, you often will see tighter bid-ask spreads during the morning trading hours in Canada, when the underlying securities are still trading in their local markets.

When local markets are closed, the prices of international ETFs tend to reflect events occurring in North American markets. The result can be that large market swings can have a greater impact as investors use the North American markets as a proxy for what may happen in the international markets. This can cause wider bid-ask spreads and additional volatility.

4 Consider the impact of trading on foreign holidays

Many Canadian-listed ETFs hold U.S. or other international securities. These securities will trade on all days the Canadian exchange are open, even if the underlying securities are not trading due to a local holiday. For example, when the U.S. markets are closed for a holiday, such as U.S. Thanksgiving, Canadian-listed ETFs will still trade. However, because the underlying securities aren't trading during these times, bid-ask spreads can increase.

5 Be aware of political and economic announcements

Markets are unpredictable in the short term, and key economic announcements introduce greater fluctuations to securities values and can potentially increase bid-ask spreads. Trading in the period immediately preceding an important geopolitical event can be very volatile.

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