ETF TRENDS
Setting the pace

How to Trade Large Blocks of ETFs Efficiently

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Imagine a world where you can have any exchange traded fund (ETF) you want. A world in which trading volume, assets under management and a wide bid/ask spread no longer are feared. Thanks to ETF providers and a growing industry of what are known as “alternate liquidity providers,” it can happen.

Advisors, institutions and retail investors have had certain long-held notions about ETFs and what determines liquidity that simply no longer hold true.

When you’re dealing in volume, buying and selling an ETF isn’t just a matter of finding a fund with all the qualities you desire – billions in assets, heavy trading volume, strong performance, low cost – and clicking “buy.” Attributes such as trading volume and assets used to be major considerations for investors because it tended to be that low activity in a fund led to wide spreads, bigger costs and, in a worst-case scenario, no one to buy the fund you’re holding when you’re in the market to sell it.

A Wider ETF Universe

The existence of people who facilitate the process of trading ETFs by providing a market for even the most thinly-traded fund is opening up new worlds for advisors and investors, making it possible for them to invest in ETFs that they once feared would be illiquid. [The 4 big benefits of ETFs.]

While what they do isn’t new – they’ve been around more or less as long as ETFs have –but there weren’t as many as there are now. And just like ETFs have made it possible for investors to access futures, currencies and far-flung global markets that previously were only open to institutions, alternate liquidity providers have expanded beyond institutional clients to registered investment advisors (RIA) and financial advisors. The services of liquidity providers give these advisors better access to price discovery and execution.

David Abner, director of institutional ETF sales and trading at **WisdomTree**, is one such person. After helping Bear Stearns build up their ETF trading business and making markets for institutional clients, he moved over to WisdomTree in 2008. The mission: help educate clients on how to trade ETFs from an issuer standpoint. The position at WisdomTree was created in response to a sharp uptick in ETF interest on the part of RIAs.

“What’s happening is that the client base is actually changing. ETFs are being picked up by registered investment advisors in droves, and these guys are primarily mutual fund investors,” Abner says. Abner is author of the forthcoming book, *The ETF Handbook*, which is scheduled to launch in March.

More Access for Advisors

Advisors may not have the same access to an institutional ETF desk, something WisdomTree found to be a growing issue. The job of Abner's team is to hand-hold advisors through the process of the execution of a trade, although ETF providers don't do any execution themselves.

"Advisors are starting to use ETFs and trading them in big sizes, not just little pieces." This can lead to confusion – if advisors don't know the volume or the spread on a fund, then two key pieces of information they need to trade large blocks are missing.

Abner defines large blocks of shares as anything above 5,000-10,000 shares. "It's valuable to understand how to trade that kind of size in an ETF," Abner says. "Because ETFs have this additional liquidity beyond the displayed trading volumes and you need to get people to access that liquidity for you."

WallachBeth is an agency broker-dealer that sources liquidity by linking up institutional clients with an expansive liquidity network, who compete for the orders that cross their desk. The winner is the corresponding best bid or offer. The company's ETF desk was formed out of a desire to quell growing advisor fear and misconceptions about certain ETFs.

"When advisors see light volume in the visible market, the environment as they know it is red-flagged to avoid it," says Erik Ambrose, head of institutional sales at WallachBeth. That fear can cut down an advisor's ETF options down from more than 800 to 400 or fewer.

Getting the Best Price

The ETF desk at WallachBeth is "100% dedicated to finding the best price that exists in an ETF security in the appropriate quantities, and delivering it in its raw form to the customer," Ambrose says. "Our sole objective is getting the best price."

Advisors until recently had very little access to the type of service that WallachBeth offers, which is part of the reason the company started its ETF desk. "It's a game changer in the marketplace," Ambrose says. In the ETF world, desks like WallachBeth's help by making sure the market impact of large orders is kept to a minimum while also ensuring that advisors pay a fair price.

WallachBeth prides itself on its transparent pricing and reporting structure, as well as its deep bench of experienced traders. They have more than 25 traders with an average experience level of about 12 years.

What happens after you buy a thinly traded ETF and you want to sell it? "We always quote a two-way market," says Andrew McOrmond, WallachBeth's managing director. "We're not taking the other side of the trade ourselves, so we have nothing to gain or lose by which direction the RIA chooses to go with an investment."

Buyers, Sellers and Pricing

Paul Weisbruch, vice president of ETF and index sales at **StreetOne Financial**, agrees. "We're agnostic as to whether we're the buyer or the seller. I make it a point to tell people that the pricing of the ETF is not a function of whether there is a buyer or seller around in the ETF at that point in time, but rather a function of the dynamic liquidity of the underlying market."

StreetOne Financial is another alternate liquidity provider that not only helps advisors get their trades executed efficiently, but they go the extra mile to work with RIAs and portfolio managers to assist them in finding the ETF that gives the exposure they're seeking, as well as provide daily technical market commentary and actionable ETF trade ideas. [The point of diversification.]

Weisbruch says the firm's goal is to be aligned with product issuers while making it feasible for everyone to use all the ETFs out there without losing basis points due to poor trade execution when buying or selling a position.

The point at which an alternate liquidity provider becomes involved is up to the advisor. RIAs and institutional clients can contact an ETF provider, who will guide them through the process, or the liquidity provider can be called directly. The liquidity provider will handle the trade from there, all the way down to delivering an ETF with average pricing. Alternately, the advisor's custodian can call the liquidity provider and get the trade done that way. At the end of the day, Weisbruch says, "It shouldn't cause you any more work operationally to get the trade done, and the benefits are better pricing and the recapture of basis points that otherwise would be lost in the marketplace."

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