

# Diversify and Invest globally with over 1000 Exchange Traded Funds

Access 9 major ETF markets at your finger tips at POEMS

PhillipETF. Enquiry: 6333 0383 | etf@phillip.com.sg

## ETF's Nuts & Bolts (Part 3)

### Myth about ETF's Liquidity & Market Makers

15 July 2010 By Goh Qian Ying | gohgy@phillip.com.sg

\* Screenshot: Bloomberg



The liquidity of an ETF is one of the commonly misunderstood issues among investors. Unlike stocks where liquidity largely depends on the trading volume, the liquidity of an ETF is typically more than its trading volume.

Two things to note about ETFs.

First, ETFs are **open-ended funds** which mean that units can be created or redeemed depending on market demand. Second, when there is no buyer or seller in the secondary market, there are **market makers** to ensure liquidity.

#### Who are the market makers?

Market makers are usually large financial institutions such as broking houses or international brokers appointed by ETF fund managers. Example - Deutsche Bank AG, Societe Generale Group, Citigroup Global Market Singapore Securities, Credit Suisse Securities.

**Market Makers** provide continuous bid/ask quotes on the stock exchange to ensure availability of prices and liquidity. The prices quoted are based on the Indicative Net Asset Value (iNav) of the ETFs.

The price of an ETF is calculated by the appointed market maker, based on the underlying asset. As such, a huge buy order in the market will not affect the price of an ETF but instead new units will be created to meet the demand.

The same mechanics apply when there is a huge sell order. The ETF's price will not be affected but instead the ETFs will be redeemed by the market maker or participating dealer.

Besides providing the price, market makers are also ready to buy and sell their ETFs from investor in the secondary market.

For Education purpose only. \* This publication is provided to you for general information only and does not constitute a recommendation, an offer or solicitation to subscribe for the investment. You should understand and carefully consider each ETF's investment objectives, risks, charges and expenses before investing. ETFs are subject to investment risks including possible loss of the principal amount invested. You may wish to seek advice from a financial adviser before investing. In the event you choose not to do so, you should consider whether the ETF is suitable for you. Information of each ETF can be found in the respective Prospectus from the Issuer's website

Figure 1 : Comparing stocks and ETFs

Stocks	ETFs
Closed-end structure –fixed number of shares	Open-ended structure
Prices driven by market supply and demand	Prices driven by market supply and demand as well as quotes from the market maker based on the iNAV
Trading of a stock is done among buyers and sellers	Market maker(s) is/are appointed to ensure trading liquidity. Trading can be done between market makers, buyers and sellers.
All trades are reported	Under reporting as not all trades are required to be reported. Usually in creation/redemption transactions.

Not all exchanges require ETF fund managers to appoint a market maker as the ETF's itself has enough volume for trading in secondary market. The US market is a good example where the monthly trading volume of ETFs can be 25%-30% of the entire market's monthly trading volume.

### Do you know?

The revised SGX listing requirement specified that it is compulsory for all SGX-listed ETF to appoint a designated market maker.

There are only five ETF that have been cross-listed here in 4 May 2001 (early stage of SGX ETF history) have no market maker:

- (1) DIAMONDS®;
- (2) iShares Dow Jones US Technology Sector Index Fund;
- (3) iShares S&P 500 Index Fund;
- (4) iShares MSCI Singapore Index Fund;
- (5) SPDRs® S&P 500® ETF