

# Five Tips for Trading ETFs

by Ron Rowland

The importance of execution is directly related to your time horizon. If you're planning to hold an ETF position for years, a few pennies on the entry and exit may not seem so important. However, those same pennies can add up quickly if you're moving in and out every week.

With that in mind, here are five suggestions to help improve your ETF trading results ...

## Trading Tip #1:

*Shop Around for Lower Commissions*

Years ago, the only way to get into the stock market was through a broker, who charged dearly for his trouble. Now the story is different. You can bypass the smooth-talking salesman and buy stocks, mutual funds, and (best of all) ETFs online for a very small fee.

If you deal with a full-service broker, he'll probably try to justify his exorbitant paycheck by telling you his firm really "works" your orders to get the best price. If you're throwing around millions of dollars at a time, this may be true.

For the rest of us, you probably aren't getting any better execution than you would at a discount broker. In fact, you may do better at a discount broker that doesn't have a proprietary trading desk working against you.

These days it's not hard to find reputable discount brokerage firms with rates of \$7-\$8 for a typical small trade. And there's really no reason to pay any more.

## Trading Tip #2:

*Get Inside the Spread*

If you look at an ETF quote during market hours, you'll probably see some numbers called "bid" and "ask." They may be quite different from the "last" trade price.

Bid and ask are the current market prices. The bid is the highest advertised price that you can get if you're selling right now. The ask is the lowest advertised price you'll pay if you're buying right now. The "spread" between these numbers is how market makers earn a profit.

The key word here is "advertised." Often you can buy for less than the ask, or sell for more than the bid. That's why it is usually a good idea to try for a price somewhere between the bid and ask.

For instance, if you want to buy an ETF that has a bid/ask of \$25.50/\$25.80, try placing a limit order at \$25.65. Wait a couple of minutes and see if anyone takes the bait. If they do, you just saved yourself fifteen cents a share.

Also keep in mind that the bid and ask aren't unlimited. They apply only to a certain share quantity. A bid of \$25, for instance, may be good only for 100 shares. Sell any more than that and you'll get a lower price — and it could be a lot lower!

### **Trading Tip #3:**

#### *Use Limit Orders*

Notice that I said in the above example to enter a "limit" order. This is simply an instruction to your broker not to process the trade unless the price is at or better than the limit you define.

If you enter a "market" order, you might not get the best price. What you will get is the best available price at that moment. And it could be substantially higher or lower than you thought you'd get.

I've found that it's almost always better to use a limit order when trading ETFs, even if it means your order isn't filled right away. The odds are that you'll get a better price by waiting.

Exceptions are a handful of mega-ETFs like SPDR S&P 500 (SPY) and PowerShares QQQ (QQQQ). These big, actively-traded ETFs normally have very tight spreads and ample liquidity. Small orders are filled instantly at the quoted bid or ask price.

#### **Trading Tip #4:**

##### *Watch the Underlying Market*

Several factors define an ETF's liquidity. One of the most important is the depth of the underlying market. This is the basket of stocks that compose the ETF. Institutional trading desks often try to pick up some quick profits by moving back and forth between ETF shares and baskets of the corresponding index.

If the index is composed of large, actively-traded stocks, the ETF will probably have an efficient market as well. Likewise, when the index consists of low-volume stocks, any ETF designed to reflect it will also reflect the lack of liquidity.

Everywhere you turn in the markets, there's confusion, risk ... and uncertainty. You want to protect the capital you have while positioning yourself to profit at the same time ... but you don't know how, or where, or with whom.

But you can board the bullet train to financial freedom ... and enjoy profits of more than \$396,000 over the next 6 months.

To get the full details on this potentially life-changing opportunity, [click here](#).

It also helps for the underlying market to be open when you're trying to trade an ETF. For instance, if you're trading an international ETF composed of European stocks, you may do better in the morning. That's because there's a few hours in the morning when the European and the U.S. exchanges are open. This means more depth and, usually, better prices.

#### **Trading Tip #5:**

##### *Be Aware of the Crowd*

On a normal day the stock market tends to have a lot of volume in the first half-hour or so, less action in mid-day, and furious trading just before the close. The same is true of ETFs.

This pattern can work either for you or against you. If you're trying to move a big quantity of shares, you probably want to take advantage of the depth present in the last hour. If you want to trade against someone who may not have thought ahead, you might find some good prices at lunchtime.

The point is that you must be aware of your surroundings. Market conditions are constantly changing. Just as you don't go out in the rain unless you want to get wet, you shouldn't go into a thin market unless you're ready to turn it in your favor.

Follow these five trading tips and you'll be surprised how much your results can improve. Are they magic? No, not at all.

You'll still have plenty of ups and downs. But good trade execution is still a very important step for more active investors.

Best wishes,

Ron

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