VanEck®

Access the opportunities.

UNDERSTANDING ETF LIQUIDITY

One of the many benefits ETFs provide investors is liquidity and ETFs trade on ASX under a set of rules designed to facilitate liquidity.

When it comes to liquidity, the two most important points to understand are:

1. **Definition:** A liquid investment can be readily acquired and converted to cash.
2. **Impact on price:** A liquid investment can be bought or sold at a fair value without a significant premium or discount to its fair value.

As an example, ASX provides a market that facilitates share trading. For larger companies whose shares trade all the time, such as CBA and BHP, liquidity is high. There are always so many buyers in the market that shares such as these can be sold on ASX quickly at a fair price.

Smaller companies tend to be less liquid. This is because there are typically fewer buyers so market forces allow them to extract an 'illiquidity discount' from anyone who needs to sell. For sellers, illiquidity pushes the price down, often below fair value.

ETFs do not have this illiquidity issue because under ASX rules, ETF issuers must appoint a 'Market Maker' to facilitate liquidity on ASX.

Market Makers do exactly as their name suggests. They make markets by matching buy and sell orders for investors that want to trade shares in an ETF, known as 'units'. In terms of liquidity, what this means for you as an investor is that when you want to sell, the Market Maker will buy your ETF units from you.

Market Makers offer to buy at the net asset value (NAV), which is the fair value of the units, plus a small spread. The 'spread' is to reward them for the service they are providing.

The result is a favourable outcome for investors. ETF investors can buy when they want and sell when they need, at a price very close to the fair value of the ETF unit, thereby avoiding large premiums and discounts no matter the market conditions.

It is important that you understand liquidity as it impacts how quickly you can access your money and the value of your investments.

FOR MORE INFORMATION

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