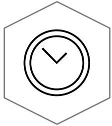
HSBC
Asset Management

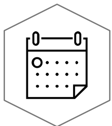
Guide to ETF trading

For Professional Clients only



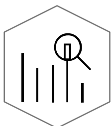
Timing is important

- **Guideline #1:**
  Generally, it is better to trade an ETF when the benchmark underlying markets are open for trading.
- **Guideline #2:**
  If the underlying market is not open at the same time as the ETF then spreads generally improve during US trading hours.



Market open and close

- **General guideline:**
  It is often advisable not to trade ETFs around the open and close of the market.
- **Why?**
  There may be less liquidity available or more volatility around prices. During the open, the market absorbs overnight news so there is uncertainty around stock prices and some market makers withdraw quotes. During the close, there are an increased number of orders in the underlying stocks waiting to be executed at close (for example, to follow index valuations) so there is the risk of increased volatility.
- **Anything else?**
  The time around significant economic announcements such as 'non farm payroll' data for example can also be more volatile with less liquidity available.



Watch out for volatility

- **General guideline:**
  ETFs reflect their underlying markets. Therefore, when the market is volatile, ETF spreads may be wider just like the underlying securities also premium/discounts may increase.
- **Why?**
  Use of limit orders is usually appropriate for ETFs and may be even more beneficial during volatile periods.
- **Anything else?**
  Limit orders define the price you are willing to pay and might need to be updated as markets move.

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Liquidity

- **General guideline:**

  Liquidity is determined by primary and secondary factors.

- **Primary factors:**

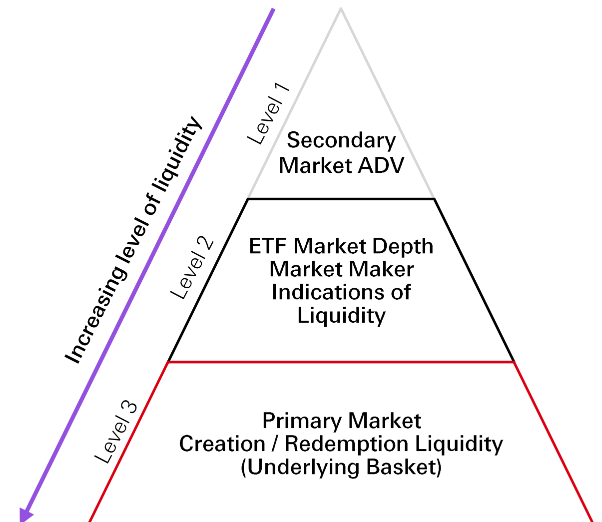
  The composition of the ETF, the creation and redemption process, and the trading volume of the underlying securities are primary factors. ETFs are generally at least as liquid as their underlying securities.

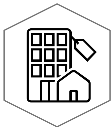
- **Secondary factors:**

  Secondary market ETF volume and inventory can add extra layers of liquidity.

- **Watch out:**

  It is important not to measure an ETF the same way as a share. ETFs are a wrapper for the underlying securities and source their liquidity from that.





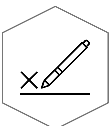
Risk price or NAV?

- **Risk price:**

  Exchange trades are executed at risk, meaning the market maker takes the risk of any pricing differences until primary market execution at NAV. Off-exchange investors can trade either on the intra-day ('risk' price) or at the end of the day NAV of the ETF. A risk price may be more useful for tactical positioning and when market timing is important but may carry a higher cost to account for the extra risk taken by the market maker.

- **NAV:**

  NAV execution may be used for longer term positioning or when 'switching' from competing ETFs. It will often be a cheaper way of gaining exposure.



OTC – Over the counter / Off-exchange

- **When to use OTC:**

  Larger trades may find better execution costs in the OTC market. There are reduced risks for liquidity providers in the OTC market as they are quoting their price to one client only per request, meaning they can price more aggressively.

- **Controlled execution:**

  The investor can always use the exchange price as reference price to ensure they are getting a better deal.

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Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- **Concentration Risk:** The Fund may be concentrated in a limited number of securities, economic sectors and/or countries. As a result, it may be more volatile and have a greater risk of loss than more broadly diversified funds
- **Counterparty Risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations
- **Derivatives Risk:** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset
- **Emerging Markets Risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks
- **Exchange Rate Risk:** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly
- **Index Tracking Risk:** To the extent that the Fund seeks to replicate index performance by holding individual securities, there is no guarantee that its composition or performance will exactly match that of the target index at any given time ("tracking error")
- **Investment Fund Risk:** Investing in other funds involves certain risks an investor would not face if investing in markets directly. Governance of underlying assets can be the responsibility of third-party managers
- **Investment Leverage Risk:** Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source
- **Liquidity Risk:** Liquidity Risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors
- **Operational Risk:** Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things
- **Real Estate Investments Risk:** Real estate and related investments can be negatively impacted by any factor that makes an area or individual property less valuable

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