



## The True Liquidity of an ETF

### How does the ETF liquidity mechanism work?

#### First level of liquidity – On the exchange

The interaction between buyers and sellers creates the first level of liquidity for an ETF. This natural liquidity is established when a sell order from an existing unit holder is matched with a buy order from a purchaser on the exchange. Popular and established ETFs with high transaction volumes can develop even greater liquidity than their underlying holdings.

#### Second level of liquidity – Market maker activity

Market makers are responsible for posting bid and ask offers on the exchange. This enhances liquidity and allows a buyer or seller to transact with minimal trading costs. Market Makers continually post units at a price which reflects the spread of the underlying portfolio.

#### Third level of liquidity – Unit creation based on underlying securities

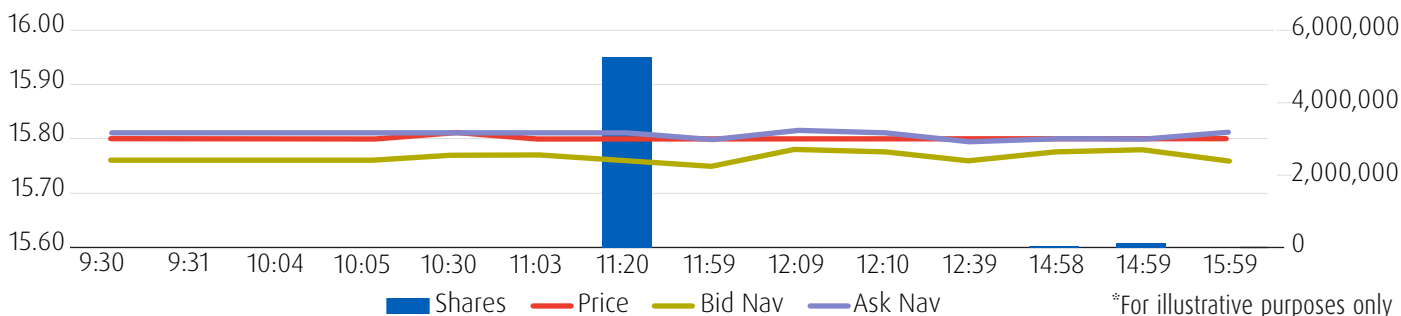
Market makers can offset an increase in demand by creating more units. On the other hand, when the demand for the units decreases, the market maker redeems units to tighten supply. When a large buy order occurs, the market maker will buy the basket of securities and initiate a creation order with the ETF provider.

When evaluating ETFs, the underlying liquidity is what matters. The true liquidity of an ETF is best measured by the liquidity of its underlying securities and can be enhanced with mature ETFs.



The chart below illustrates a large trade placed on BMO Aggregate Bond Index ETF (ZAG). An \$80 million dollar trade had no impact on the trade’s execution price. The true liquidity an ETF is best measured by the liquidity of its underlying securities and allows for significant trade orders without having an impact on the price of the ETF itself.

### Large Trade on ZAG



Risk is defined as the uncertainty of a return and the potential for capital loss in your investment.

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