The Liquidity Myths on ETFs

Liquidity refers to the ability to buy or sell a security quickly, and at a reasonable transaction cost. Given that ETFs and individual stocks both trade on a stock exchange, many investors mistakenly believe that the liquidity characteristics of the two are similar. However, they are not. Often, ETF liquidity is greater than most investors assume.

Myth #1

ETF Asset Levels or Trading Volumes Are Good Proxies for ETF Liquidity

Thanks to the 'creation and redemption' mechanism, ETF liquidity is predominately determined by the liquidity of the underlying individual securities that make-up the ETF.

Perhaps the most common ETF misconception is that low daily trading volumes or small amounts of assets under management (AUM) indicate that an ETF is illiquid. The reality however is that ETFs function fundamentally different than individual stocks or closed-end funds.

Unlike individual stocks or closed-end funds, which usually have a fixed supply of shares in circulation on the secondary market, ETFs are open-ended investment vehicles. This means that ETFs are able to issue or withdraw shares on the secondary market according to investor supply and demand, otherwise known as creations and redemptions. This ability gives ETFs a unique liquidity profile in comparison with stocks and closed-end funds.

To illustrate to investors who may be skeptical that small- or low-trading volume ETFs can be highly liquid, let's use Cambria Global Real Estate ETF (BLDG) as an example.

BLDG is a relatively new ETF to the Cambria ETF line-up, which like most new product launches shortly after launch have a low trading volume history. BLDG invests in broad, highly-liquid real estate securities around the globe. While the underlying securities are highly liquid, BLDG does not trade much and trades that do occur are generally modest in size.

Nevertheless, one-large trade for 158,691 shares (~$4.58m), which doubled BLDG's assets, was successfully executed at $28.86 per share on 1/5/21. The trade didn't affect BLDG's ETF price. In fact, Cambria's product team worked with the financial advisor's (FA's) trade desk. The FA's trade desk sent out an RFQ (Request for Quote) to various Market Makers to find the best price. One was found, and the trade was executed 11 cents below the on-screen price.

On a 158,691 share trade, that was a savings of ~$17,500 for the advisor's clients.

SOURCE: Bloomberg. Data from 9/24/20 to 1/26/21

Myth #2

Secondary Market ETF Liquidity Is Limited To What You See 'On Screen'

The reality is that ETF investors can often access significant 'hidden' ETF liquidity beyond what is directly observable in the secondary market.

We mentioned 'on screen' liquidity before, but let's dive into it a bit more by separating large ETF trades and smaller ETF trades to access liquidity.

Larger ETF Trades:

Investors with large ETF trades can tap into the primary market by working directly with an AP (Authorized Participant) to create or redeem shares with an ETF manager.

APs occupy a unique position in the ETF environment: They are the only entities allowed to deal directly with an ETF, buying and selling ETF shares at intrinsic, or net asset value (NAV). All other ETF investors must buy or sell ETF shares in the secondary market (usually a stock exchange) where investors bargain continuously over ETF price.

Smaller ETF Trades:

For smaller ETF trades that aren't large enough for creation and redemption, there is often still much more secondary market liquidity available than many investors realize. Particulary, if those investors gauge liquidity by just looking at the exchange order book.

Exchange order books typically only display a small fraction of the volume market makers are willing to trade. For example, a market maker might only publish an order to buy 1,000 shares (bid) and an offer to sell 1,000 shares (ask) even though they might actually be willing to trade tens of thousands at the same price. Small quote sizes enable market makers to manage the financial risk associated with unexpected events, such as sharp market moves or trading algorithm malfunctions. For investors it's recommended they take a few simple steps to for better execution.

Work with an ETFs issuer's capital market desk

At Cambria ETFs, financial advisors can reach out to their Regional Investment Consultant. In turn, the Regional Investment

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Consultant and the financial advisor can work with Cambria's desk to take advantage of the wider range of liquidity options available to them.

Cambria's capital market desk maintains relationships with APs and institutional trading desks to help facilitate trade execution. Even if a trade is not large enough to justify contacting an ETF issuer, many broker dealers also provide trading services than can help advisors and investors locate ETF liquidity and trade efficiently.

Using limit orders for ETF trading

It's advisable for ETF investors, especially when dealing in thinly traded ETFs, to enter limit orders instead of market orders. A limit order enables investors to define a specific maximum (buy limit) or minimum (sell limit) price for their trade and helps protect against the risk that the trade is fulfilled at a prices that deviate significantly from its NAV.

Myth #3

It Doesn't Matter When You Trade an ETF

Trading ETFs without considering liquidity fluctuations during the trading day can result in less cost-efficient ETF transactions, but a little effort and preparation can avoid these challenges.

ETF liquidity is variable largely because ETFs reflect the liquidity of their underlying securities and most underlying securities do not have constant liquidity. Fluctuations in ETF liquidity become evident when looking at ETF bid-ask spreads, which narrow when underlying security liquidity is robust and widen when it is not. Experienced ETF investors keep this in mind when planning a trade.

Certain ETF liquidity patterns tend to repeat and are well known to veteran traders. For example, U.S. equity markets tend to be less liquid during the first 30 to 60 minutes after markets open and the last 30 to 60 minutes before the market closes.

At the start of the trading day, markets attempt to digest overnight news and orders may be lined up, waiting for execution at the opening bell. As a result, early-morning liquidity can be limited as orders are executed all-at-once. At the end of the trading day, liquidity for ETFs and underlying securities can diminish as late orders hit the market before the close, making it difficult for ETF market makers and APs to execute orders.

The end result is that ETFs may be quoted with wider bid-ask spreads at the beginning and at the end of the trading day.

In Summary...

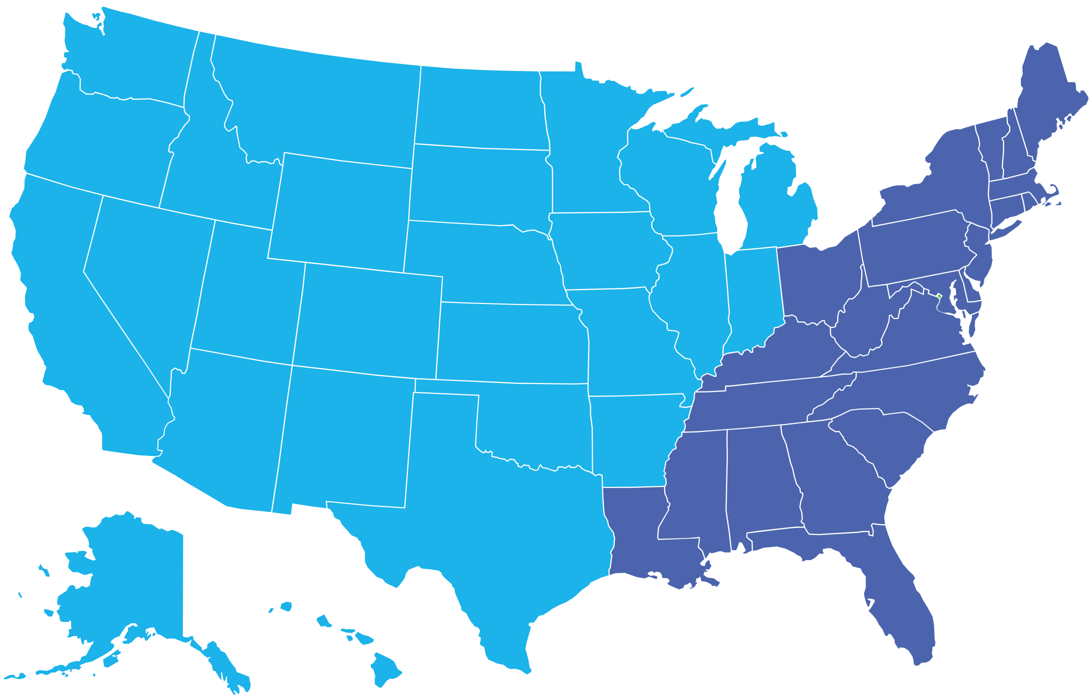
ETF liquidity is in fact, different and more dynamic than stock liquidity.

It's important to look beyond trading volume and on-screen indicators of liquidity. The table below summarizes some of the key insights and translates them into a handful of practical ETF trading tips. Although ETFs have many characteristics that are similar to stocks, liquidity is not one of them.

- View the ETF's underlying securities to determine liquidity. Don't rely on the ETFs trading volume or AUM.
- Use limit orders. Rarely use market orders.
- Consider the time of day when placing trades. Avoid trading with first 60 minutes of market open and the last 60 minutes of the trading day.
- If unsure, call for help. Don't go it alone.

Speak with your financial advisor or Cambria to learn more about ETF liquidity, or if you need help in executing the best price for your Cambria ETF order.

For more information, visit www.cambriafunds.com



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To determine if Cambria Global Real Estate ETF (BLDG) is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expense before investing. This and other information can be found in the Fund's prospectus which may be obtained by calling 855-383-4636 (ETF INFO) or visiting www.cambriafunds.com. Read the prospectus carefully before investing or sending money.

Cambria Global Real Estate ETF (BLDG), the Fund's investments are concentrated in real estate-related industries, and the Fund may be susceptible to loss due to adverse occurrences affecting these industries including declines in the real estate market, decreases in property revenues, increases in interest rates, increases in property taxes and operating expenses, legal and regulatory changes, a lack of credit or capital, defaults by borrowers or tenants, environmental problems and natural disasters. The availability or mortgages and changes in interest rates may also affect real estate values.

Cambria Global Real Estate ETF is actively managed.

Authorized Participant: An Authorized Participant (or, AP) is an organization that has the right to create and redeem shares of an ETF. Aps private a large portion of the liquidity in the ETF market by obtaining the underlying assets required to create the shares of an ETF.

Bid-Ask Spread: The amount by which the ask price (sell order) exceeds the bid price (buy order) for a security.
Market Maker: Market Makers maintain continuous two-way ETF orders (bid and ask), and are a key input to exchange order books.
Market Orders: An order to buy or sell a security immediately at the best available current price.
Net Asset Value (NAV): Represents the value of each share's portion of the fund's underlying assets and cash at the end of the trading day.
Order Book: Order Books (aka, Exchange Order Books) provide an inventory of open bid and ask orders (including both price and size) for a given security.

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ETFs are subject to commission costs each time a "buy" or "sell" is executed. Depending on the amount of trading activity, the low costs of ETFs may be outweighed by commissions and related trading costs.

Shares are bought and sold at market price (closing price) not net asset value (NAV) are not individually redeemed from the Fund. Market price returns are based on the midpoint of the bid/ask spread at 4:00pm Eastern Time (when NAV is normally determined), and do not represent the return you would receive if you traded at other times. Buying and selling shares will result in brokerage commissions. Brokerage commissions will reduce returns.

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