How ETPs work

ETP is a fund that trades like a stock

In contrast to the mutual fund, ETPs are listed, bought, and sold on a regulated stock exchange, typically through a broker or brokerage platform.

ETPs offer the opportunity to invest in a portfolio of assets that provide diversification benefits with liquidity and trading flexibility.

Primary and secondary markets

The primary market is where certain institutional investors create and redeem them

The secondary market is where individual investors buy and sell them.

The primary market can play a critical role in providing investors with the best possible price for an ETP trade, especially for large orders. So, it is important to understand what occurs in both the primary and secondary markets.

The primary market

Primary market participants include:
- ETP issuer (i.e., Pando Asset)
- Authorized Participants (APs), which are institutions authorized to create and redeem ETPs
- Market makers, which provide liquidity and may also function as APs

ETPs are created through the interactions of participants in the primary market before being able to be traded on the stock exchange.

ETP creation and redemption

Exhibit 1 illustrates the C/R process.

An AP applies to the ETP issuer for a creation unit, say 5,000 units. In essence, the AP is creating ETP shares through a direct purchase from the ETP issuer. AP will transfer the basket of the underlying assets (in-kind creation), or cash (cash creation) that equals the value of the creation unit.

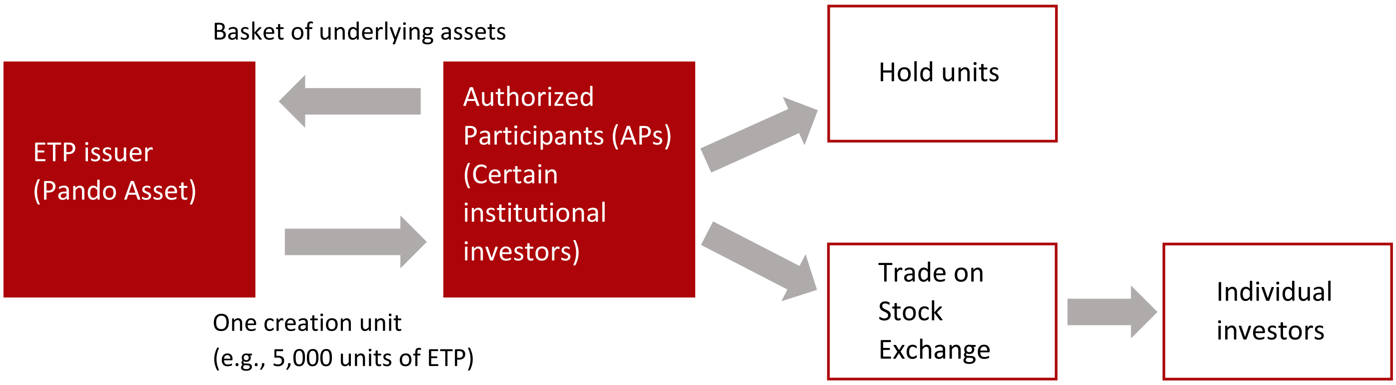
Information about the basket of the underlying assets is published each day and reflects the value of cash or underlying assets that the AP will need to provide to the ETP issuer in exchange for the ETP unit. The weights of individual underlying assets in the basket reflect their weights in the index that the ETP seeks to track.

Upon settlement, the AP has an inventory of ETP units that can be sold in the secondary market.

The redemption process works in reverse. The AP applies to the ETP issuer to redeem whole creation units and in return receives a basket of underlying assets (in-kind redemption), or a cash equivalent (cash redemption).

By creating and redeeming shares directly with the ETP issuer in large blocks, APs provide liquidity to investors looking to trade the ETP.

Exhibit 1: The creation and redemption process



The secondary market

In the same way as trading stocks, individual investors will trade the ETP through a brokerage firm. Units can be bought and sold at the current market price whenever the stock exchange is open.

Unit prices typically reflect the approximate NAV of the ETP's underlying asset at any given point in the day.

ETP pricing

The secondary-market price of ETP units may be more or less than the net asset value (NAV) of the underlying securities. Several factors influence an ETP's price in the secondary market, including the price movement of the underlying assets and investors' demand for the ETP.

The ETP issuer calculates and publishes the ETP's NAV daily. The published NAV is based on the underlying assets' closing market prices minus the ETP's fees and expenses.

Bid-ask spreads

Market makers provide liquidity by facilitating trades in the secondary market. Through adjusting for continuous market movements in the ETP's underlying assets, market makers set intra-day bid and ask prices for the ETP.

The difference between the bid and ask price is known as the bid-ask spread. A bid price is the price at which secondary-market participants are willing to purchase shares. An ask price is the price at which secondary-market participants are willing to sell shares.

Trading order types

Since ETPs trade like stocks anytime during regular exchange hours, market order, stop order, and limit order can be applied.

A market order is an order to buy or sell a security immediately at the market price.

A stop order is an order that triggers a market order to buy or sell an ETP once it reaches a certain unit price, known as the stop price.

A limit order is an order to buy or sell an ETP at a specified price or better.