VIDEO

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ETFs and the Markets

ICI Explains

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Millions of people depend on the markets to help them save toward financial goals, so it's unsurprising that market volatility is unsettling. Though analysts often point to ETFs as one of the culprits, ETFs actually drive very little of that volatility. In this short video, ICI Senior Director of Industry and Financial Analysis Shelly Antoniewicz, discusses a common misperception about exchange-traded funds, or ETFs.

About Shelly Antoniewicz

This video is narrated by Shelly Antoniewicz, senior director of industry and financial analysis at ICI, where she conducts research on the structure and trends of the US and global ETF, mutual fund, and closed-end fund industries and on the equity and bond markets in the United States and globally. She earned a BA in management science from the University of California, San Diego, and an MS and PhD in economics from the University of Wisconsin–Madison.

Transcript

Shelly Antoniewicz: Hi. I'm Shelly Antoniewicz, a senior economist at ICI. Today, we're going to unpack a common misperception about exchange-traded funds, or ETFs.

If you invest in the stock or bond markets, you probably already know that it's not always a smooth ride. Sometimes, we can encounter twists, turns, and sharp swings in prices from one day to the next—or even in the same day.

Many millions of us depend on the markets to help us save toward our big financial goals—like education, a down payment on a home, or retirement. So it's no surprise that market volatility unsettles us and puzzles the analysts who try to pinpoint the causes.

What issurprising is that during periods of market volatility, analysts often point to ETFs as one of the culprits. But in truth, ETFs actually drive very little of the volatility.

Let's look at two examples from the US stock market in 2018.

In early February—when broad equity indexes fell sharply after years of relative calm—investors traded nearly $1.9 trillion in company stocks, or almost $400 billion more than during the week before. That’s a lot of trading, yet creations and redemptions of US equity ETF shares accounted for just 3.2 percent of it. We’re talking about three pennies for every dollar in trading of company stocks.

When volatility returned in mid-December, the story was similar. As equity indexes gyrated, more than $1.7 trillion in company stocks changed hands—or about $460 billion more than during the much calmer week before. Again, creations and redemptions of US equity ETF shares accounted for a small fraction of the trading—only 4.2 percent. That’s about four pennies for every dollar in trading of company stocks.

With creations and redemptions making up such a small portion of trading in the US stock market, it’s hard to see how ETFs could be driving volatility in it. So why do some analysts claim that they do? Well, it’s likely a case of confusing the secondary market for ETF shares with the primary market.

Commentary claiming that ETFs drive market volatility almost always emerges from analysis of the secondary market, where investors buy and sell already-existing ETF shares on an exchange. But this is a mistake, because the vast majority of these transactions don’t involve the underlying securities that ETFs invest in.

Instead, analysts should be looking at the primary market, where large institutional investors, known as authorized participants, interact with ETFs directly to create and redeem ETF shares. These transactions *always* involve the underlying securities.

Now, you might be wondering: if ETFs don’t drive market volatility, what does?

Well, going back decades—to before ETFs even existed—every major bout of market volatility has been set in motion by a macroeconomic event. From Black Monday, to the dot-com bubble bursting, to the 2008 financial crisis, all the way up to our 2018 examples, a spike in volatility for every macroeconomic event. In none of these instances did ETFs play a material role.

For more information on ETFs and the markets, please visit ici.org/etf. Thanks for watching, and we’ll see you next time.

Additional Resources

- ICI Explains: Understanding ETFs
- Glossary of Exchange-Traded Fund and Other Related Financial Terms (pdf)
- ETF Resource Center