

The Effect of Exchange-Traded Funds on their Underlying Securities' Trading Costs

Bachelor Thesis

University of Zurich

Banking

Prof. Dr. Steven Ongena

Field of Study: Bachelor of Arts UZH Business and Economics

Author: Adrian Becker

Submission Date: 16.07.2020

Executive Summary

The rapid growth of exchange-traded funds in recent years has attracted the attention of many investors, financial researchers, and regulators. This research paper summarises the key mechanics of exchange-traded funds and explains their growing popularity. Furthermore, the effect of exchange-traded funds on their underlying securities will be examined. As to date, many researchers found somewhat contradicting results on whether exchange-traded funds have a positive or negative effect on their underlying securities' trading costs, pricing efficiency, liquidity, and volatility. This paper focuses on the effect on trading costs and pricing efficiency, summarises the current state of research, and aims to provide an explanation for the mixed results. In sum, exchange-traded funds appear to have a negative effect on their underlying securities' trading costs and pricing efficiency in the long run. This could affect the long-term performance of an exchange-traded fund.