The Basics Of Order Entry

With the growing importance of digital technology and the internet, many investors are opting to buy and sell stocks for themselves rather than pay advisors large commissions for research and advice. However, before you can start buying and selling stocks, you must know the different types of orders and when they are appropriate.

Market vs. Limit

The two basic types of orders that every investor should be aware of are the market order and the limit order.

1. A **market order** is an order to buy or sell immediately at the best available price. These orders do not guarantee a price, but they do guarantee the order's immediate execution. Typically, if you are going to buy a stock, then you will pay a price near the posted ask. If you are going to sell a stock, you will receive a price near the posted bid.

   One important thing to remember is that the last-traded price is not necessarily the price at which the market order will be executed. In fast moving and volatile markets, the price at which you actually execute (or fill) the trade can deviate from the last-traded price. The price will remain the same only when the bid and ask prices are exactly at the last-traded price.

   Market orders are popular among individual investors who want to buy or sell a stock without delay. Although the investor doesn't know the exact price at which the stock will be bought or sold, market orders on stocks that trade over tens of thousands of shares per day will likely be executed close to the bid and ask prices.

2. A **limit order** sets the maximum or minimum price at which you are willing to buy or sell. For example, if you wanted to buy a stock at $10, you could enter a limit order for this amount. This means that you would not pay a penny over $10 for the particular stock. It is still possible, however, that you buy it for less than the $10.

One Caveat (Beware)

When deciding between a market or limit order, investors should be aware of the added costs. Typically, the commissions are cheaper for market orders than for limit orders. The difference in commission can be anywhere from a couple dollars to more than $10. For example, a $10 commission on a market order can be boosted up to $15 when you place a limit restriction on it. When you place a limit order, make sure it's worthwhile.

Let's say your brokerage charges $10 for a market order and $15 for a limit order. Stock XYZ is presently trading at $50 per share and you want to buy it at $49.90:

- By placing a market order to buy 10 shares, you pay $500 (10 shares x $50 per share) + $10 commission, which is a total of $510.

- By placing a limit order for 10 shares at $49.90 you pay $499 + $15 commissions, which is a total of $514.

Even though you save a little from buying the stock at a lower price (10 shares x $0.10 = $1), you will lose it in the added costs for the order ($5), a difference of $4. Furthermore, in the case of the limit order, it is possible that the stock doesn't fall to $49.90 or less. Thus, if it continues to rise, you may lose the opportunity to buy.

Other Exotic Orders

Now that we've explained the two main orders, here's a list of some added restrictions and special instructions that many different brokerages allow on their orders:

- ***Stop Order***

  Also referred to as a ***stop loss***, stopped market, on-stop buy, or on-stop sell, this is one of the most useful orders. This order is different because - unlike the limit and market orders, which are active as soon as they are entered - this order remains dormant until a certain price is passed, at which time it is activated as a market order.

  For instance, if a stop-loss sell order were placed on the XYZ shares at $45 per share, the order would be inactive until the price reached or dropped below $45. The order would then be transformed into a market order, and the shares would be sold at the best available price. You should consider using this type of order if you don't have time to watch the market continually but need protection from a large downside move. A good time to use a stop order is before you leave on vacation.

- ***All or None (AON)***

  This type of order is especially important for those investors who buy penny stocks. An all-or-none order ensures that you get either the entire quantity of stock you requested or none at all. This is typically problematic when a stock is very illiquid or a limit is placed on the order.

  For example, if you put in an order to buy 2,000 shares of XYZ but only 1,000 are being sold, an all-or-none restriction means your order will not be filled until there are at least 2,000 shares available at your preferred price. If you don't place an all-or-none restriction, your 2,000 share order would be partially filled for 1,000 shares.

- ***Good 'Til Canceled (GTC)***

  This is a time restriction that you can place on different orders. A good-till-canceled order will remain active until you decide to cancel it. Brokerages will typically limit the maximum time you can keep an order open (active) to 90 days maximum.

- ***Day***

  If, through the GTC instruction, you don't specify a time frame of expiry, then the order will typically be set as a day order. This means that after the end of the trading day, the order will expire. If it isn't transacted (filled) then you will have to re-enter it the following trading day.