


How to Use a Limit Order

By Bill Mann

We’ve said a few times that you should use a limit order when you’re buying most of your *Hidden Gems Canada* stocks. A limit order gives you the ability to be more specific about how you’d like your broker to fill your trade.

When you’ve invested before, you’ve probably used a market order, which authorizes your broker to buy shares for you at whatever price is available in the market at that moment. In most cases, this presents no problem at all — you could buy or sell \$1 million worth of **Apple** (Nasdaq: AAPL) and your action would have have no impact on Apple’s price.

That’s not a luxury you should expect with microcap and many small-cap companies, some of which trade less than \$200,000 in total volume per day. Too much volume on one side or the other of them (buying or selling) can cause the share prices to move drastically, and that’s something I think we’d all like to avoid.

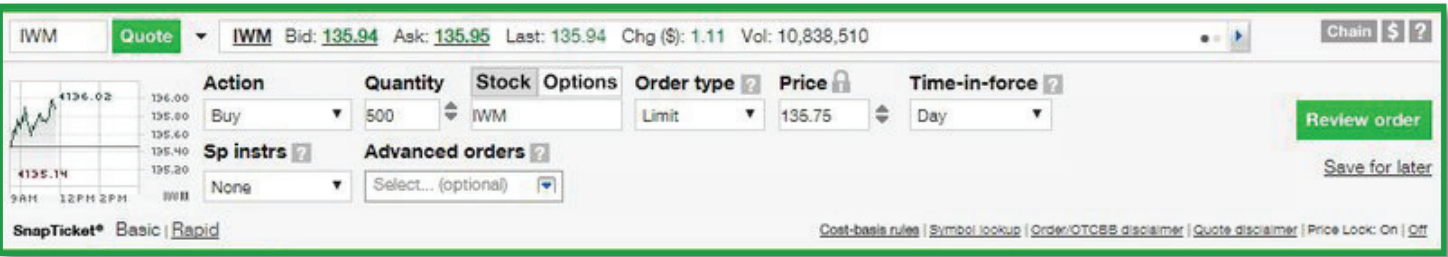
A limit order does the same thing for your trade as an invisible fence does for your dog: It provides boundaries that cannot be crossed. When you set a limit order (please note that I’m talking about *buying* here), you’re specifying the maximum price at which you’re willing to buy a stock.

Here’s how you do it. Above is a TDAmeritrade trade window. As an example, I’ve populated it as if I wanted to buy IWM, an exchange-traded fund that tracks the Russell 2000. (IWM’s average daily volume is \$3.2 billion). You can see that the current “ask” (the price at which IWM can be bought at this second) is \$135.95. But I don’t want to pay that much. So I’ve changed the order type to “limit,” and a box prompted me to enter my limit price. I typed in \$135.75. Next to that, you see a “time-in-force” dropdown menu, which lets you specify how long you will leave the order open. I chose “day.”

What all this means is that I’m trying to buy 500 shares of IWM, but instead of the current price, I’m willing to pay only \$135.75 (\$0.20 less per share), and my order is valid only for the current market day.

Got that? Saving almost \$100 by setting a price below the market (that’s \$0.20 times 500 shares) makes perfect sense, right? Why wouldn’t you use a limit order for every trade?

Well, you could. This risk, of course, is that the price doesn’t drop below \$135.75 and you end up not buying something that you wanted to own. I did that in 1997 with a little company called Starbucks (Nasdaq: SBUX). Or, as I like to call it now, ARRRRRRRGGGHHHHHHHHbucks.





Remember, Fool, your goal is to get exposure to some great micro- and small-cap Hidden Gems, not to quibble over pennies. The best way to do that with these companies is to **set your limit order either at the current price (the ask), or a little bit higher than the current price.** So if the current price is \$6.40, and a company trades \$100,000 in volume per day, maybe think about setting a limit order at \$6.50. That way you'll get the market price as long as the shares trade below your limit.

To review: **Our suggestion is that you use a limit order to buy your microcaps and that you set the limit price either at the current ask price or a few pennies above it.**

And if you end up paying a few cents more per share, who cares? Those pennies won't be what makes or breaks whether that investment is successful for you. Much more painful would be putting in a market order along with lots of other folks and then suddenly finding that your trade executed at \$9. (Also bad: Getting too fancy with your limits and pulling an

ARRRRRRRRRRGGGGHHHHHHbucks and never getting exposure to a promising company.)

And if the stock prices *do* take off? Take your time! You can buy in dribs and drabs. Work your way into the shares. **Use a "GTC" limit order instead of "day."** GTC means "good 'til canceled," and that means your limit order will sit out there in perpetuity until it's filled or you cancel it. (Actually, most brokerages do put some time limit on the amount of time a GTC order can remain open. It's usually 30 to 90 days.

The great news is that you don't have to pay any extra fees for limit orders, your commission will be the same, and you don't need any extra broker permissions. And if you use a GTC order and your trade fills over many days (which is common), you will only pay a single trade commission.

Remember, we aren't recommending you use limit orders to be fancy. We recommend them because **we don't want you to accidentally pay far, far too much for some of the market's tiniest companies.**

John Mackey, CEO of Whole Foods Market, an Amazon subsidiary, is a member of The Motley Fool's board of directors. David Gardner owns shares of Amazon and Apple. The Motley Fool owns shares of Amazon and Apple and has the following options: long January 2020 \$150 calls on Apple and short January 2020 \$155 calls on Apple.

