What is Liquidity And Why Does It Matter?

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The true value of an investment isn't just what it's worth. It's whether you can buy or sell it when it matters most.

According to ProphetX (one of the recently approved prediction markets by the Commodity Futures Trading Commission, or CFTC), liquidity is the amount available to trade. The displayed amount represents the available liquidity at specific prices. Trades up to this amount are instantly filled, while any excess is resting and placed into the market.

The Chicago Board of Options Exchange (CBOE) is aware customers not only want to enter the market but also may want to exit the market - and this is where things can get trickier, and more important — the liquidity on the way out of trade.

Liquidity matters in relation to not materially altering the price of the asset. From the customer perspective, not only do you want to get your price, but you also want to get your size done at that price. Is anything more frustrating than wanting to buy something and getting 2 or more fills? Your buy-me-100 order gets carved up to you bought 80 for 4 dollars and 20 for 4.05.

In slow and orderly markets this second layer of liquidity is generally a tick or 2 away, so not the biggest of deals. But if the markets get sideways, it is important to know where you can get your size done, and some people intentionally traffic in the most liquid products in order to get the most reliable liquidity.

The other side of a lot of trades is taken by market-makers. I came up as an option trader on the CME and CBOE. When you make a 2-sided market, the usually grumpy executing broker sometimes barks for you to put a number on it. This is their nice way of asking for liquidity, and you better be beware there could be size behind it. And the last thing you want to hear, after you sold your number, is the voice of a broker like Timmy Hendricks asking, where are you now? Clearly you execute your first batch at a price that you could have done better on.

Welcome to the game, and so far, you are down a touchdown.

"In calm markets, liquidity is convenient. In volatile markets, it's priceless.

Companies will tell you as part of a mission statement that they want to provide liquidity to the marketplace. What they mean is they want to provide profitable liquidity, at a price that hopefully both sides can indeed be profitable. But, like any profit-seeking industry, it is me first. Many of us knew someone trying to sell a house or some other asset in 2008 - when liquidity on the buy side disappeared. Liquidity, in any asset class, matters.

THE KEY TAKEAWAY

Warren Buffett famously said, *"Only when the tide goes out do you discover who's been swimming naked."*

In calm markets, nearly everything appears easy to buy and sell. But investing has a way of exposing assumptions when conditions change. That's why seasoned investors don't chase returns in isolation—they value optionality. Liquidity provides choices, and in investing, choices have value. The ability to raise cash, reposition a portfolio, or simply avoid selling into a panic is a competitive advantage that rarely appears on a performance chart but often shows up in long-term outcomes.

That's the bigger takeaway: Returns may build wealth, but liquidity protects your ability to make good decisions when everyone else is scrambling.

And sometimes, that's the most valuable investment of all.

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