What's the difference between a stop and a limit order?

Different types of orders allow you to be more specific about how you'd like your broker to fulfill your trades. When you place a stop or limit order, you are telling your broker that you don't want the market price (the current price at which a stock is trading), but that you want the stock price to move in a certain direction before your order is executed.

With a stop order, your trade will be executed only when the security you want to buy or sell reaches a particular price (the stop price). Once the stock has reached this price, a stop order essentially becomes a market order and is filled. For instance, if you own stock ABC, which currently trades at $20, and you place a stop order to sell it at $15, your order will only be filled once stock ABC drops below $15. Also known as a "stop-loss order", this allows you to limit your losses. However, this type of order can also be used to guarantee profits. For example, assume that you bought stock XYZ at $10 per share and now the stock is trading at $20 per share. Placing a stop order at $15 will guarantee profits of approximately $5 per share, depending on how quickly the market order can be filled.

Stop orders are particularly advantageous to investors who are unable to monitor their stocks for a period of time, and brokerages may even set these stop orders for no charge.

One disadvantage of the stop order is that the order is not guaranteed to be filled at the preferred price the investor states. Once the stop order has been triggered, it turns into a market order, which is filled at the best possible price. This price may be lower than the price specified by the stop order. Moreover, investors must be conscientious about where they set a stop order. It may be unfavorable if it is activated by a short-term fluctuation in the stock's price. For example, if stock ABC is relatively volatile and fluctuates by 15% on a weekly basis, a stop loss set at 10% below the current price may result in the order being triggered at an inopportune or premature time.

A limit order is an order that sets the maximum or minimum at which you are willing to buy or sell a particular stock. For instance, if you want to buy stock ABC, which is trading at $12, you can set a limit order for $10. This guarantees that you will pay no more than $10 to buy this stock. Once the stock reaches $10 or less, you will automatically buy a predetermined amount of shares. On the other hand, if you own stock ABC and it is trading at $12, you could place a limit order to sell it at $15. This guarantees that the stock will be sold at $15 or more.

The primary advantage of a limit order is that it guarantees that the trade will be made at a particular price; however, your brokerage will probably charge a higher a commission for the limit order, and it's possible that your order will not be executed at all if the limit price is not reached.

To learn more, see *How does a stop-loss order work?*, *The Basics of Order Entry* and *The Stop-Loss Order - Make Sure You Use It*.