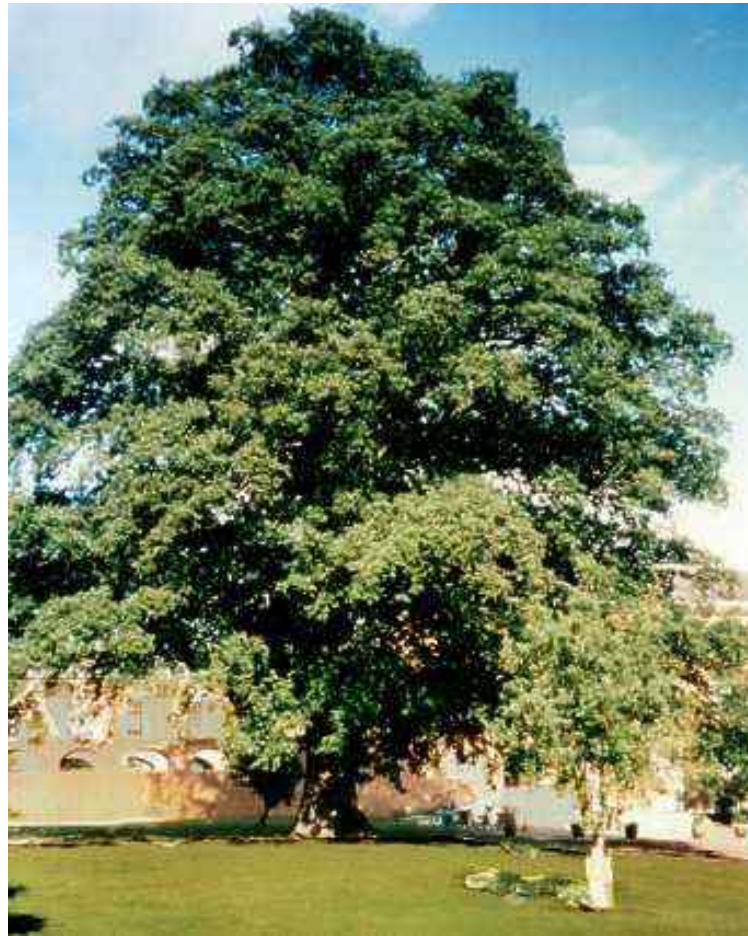


Its SHO Time!
Short sale price tests and market quality
by Diether, Lee and Werner

Discussion by
Professor Paul Irvine
Terry College of Business
University of Georgia



The Tree



Results

- Methodology
 - The methodology is pretty straightforward and rightfully so. It is rare that you have such a well-defined event sample and control sample
 - *We find a significant increase in NYSE quoted spreads from 2.937 to 3.042 cents.*
- Ask depth puzzle
- Nasdaq results

Ask depth is consistently deeper than bid depth

All over the world – Hong Kong, Paris or here in Toronto

Variable	Low volume			Medium volume			High volume			
	All	1,1	1,2	1,3	2,1	2,2,	2,3	3,1	3,2	3,3
INSIDE DEPTH	9.0	6.6	4.5	3.8	9.2	8.1	5.2	16.3	13.2	13.8
ASK DEPTH	31.2	23.1	9.9	6.7	31.1	22.6	13.1	78.8	52.1	42.7
BID DEPTH	20.3	14.0	8.2	7.1	23.5	13.7	10.8	37.0	32.4	35.2
QID / TOTAL DEPTH	25%	25%	33%	31%	22%	29%	27%	15%	18%	21%

Nasdaq results – Table 6

NYSE

Quoted bid-depth	Time	1000 shrs	-0.328	-0.73	-0.82
Quoted ask-depth	Time	1000 shrs	-3.273	-8.76	-9.24
Relative bid-depth	Time	%	11.831	22.44	22.00
Buy-Imbalance		1,000 shrs	-78.887	-8.33	-8.27
Buy-Imbalance/Volume		%	-9.215	-26.28	-27.20

NASDAQ

Quoted bid-depth	Time	1000 shrs	1.655	0.77	0.58
Quoted ask-depth	Time	1000 shrs	1.683	0.71	0.61
Relative bid-depth	Time	%	-0.155	-0.37	-0.37
Buy-Imbalance		1,000 shrs	3.186	0.57	0.49
Buy-Imbalance/Volume		%	-0.537	-1.16	-1.19

The Forest



Who the heck is doing all this shorting!?

- And where are they borrowing the stock?
- Hedge funds, sure.
- Most hedge fund shorting, or any shorting done on these markets must be reversed intraday or reported short interest ratios would be much higher.
 - This explains some of the phone calls I got this spring. There is a really short – almost trade-to-trade horizon for some of the arbitrage strategies being employed at hedge funds.
- I wonder if that is enough
 - Market makers.

Market maker participation - TSX

Client trade matched with:	<u>Discount Brokers</u>		<u>Full Service Brokers</u>	
	#trades	Effective Spread cents basis points	#trades	Effective Spread cents basis points
Other Client	19,382	11.28	98,402	9.81
	40.4%	69.9	40.6%	66.0
Professional	14,214	9.67	67,179	8.65
	29.6%	55.0	27.7%	53.2
Market Maker	14,379	6.83	77,009	7.03
	30.0%	39.7	31.7%	39.8

Uptick rules and volatility - I

The main motivation was ...concern that short-sellers would jump in when there was downside momentum – Diether, Lee and Werner (2006)

- I do not think the authors 5 and 15 minute volatility tests have anything significant to say about the Uptick rule.
- The real concern is episodes of unusual downside volatility. Does additional shorting exacerbate the price decline?

Uptick rules and volatility - II

- Idiosyncratic volatility
 - Ordinary trading conditions are not really important to the significance of the Uptick rule.
 - Are there costs to stock-specific volatility: perhaps
 - retail traders panic – debatable
 - direct and indirect costs of lawsuits
 - a whole set of indirect equity costs are possible
 - dropping the open
 - more can be done to investigate stock-specific price drops

Uptick rules and volatility - III

- Systemic volatility
 - A Washington word
 - What really happens in a systemic market drop
 - Specialists
 - Prime brokerage
 - I think the focus on the locate requirement is the relevant margin for this regulation and encourage the SEC in their efforts



Thank you
