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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

RE: File No. S7-02-10

Dear Ms. Murphy:

Thanks for the chance to comment on the Concept Release about Equity Market Structure. The Commission deserves high marks for its comprehensive assessment of equity-markets construction.

We track trading patterns for public companies, an overlooked constituency when rules are constituted. Applying sophisticated database and software tools to historical trade-execution data, we illustrate the effects of speculation, risk-management, and rational investment on public share prices. We pioneered "market-structure analytics" for the investor-relations function. We offer a unique perspective.

Market rules have for decades been set by regulators with input principally from the parties behind trading activity: broker-dealers and market centers. These constituents see the markets as fair and efficient. Principal trading has never been a more lucrative endeavor. For market centers, proliferating transactions and data are a revenue machine.

From an issuer perspective, there are serious structural problems. Equity markets are meant to form capital by matching risk-taking investors with the budding new enterprises in need of them. Instead, trillions of investment dollars have moved to private equity. Relatively few venture-backed firms go public, compared to the 1980s and 1990s (that means fewer new investor relations professionals). We count IPOs on fingers rather than pages. Debt securities surpass global public equity capitalization by almost 2-to-1[i], the bulk of which trade not on public markets but in decentralized fashion between dealers.

The problem as we see it is straightforward. Over the past 15 years, price has been made the universal denominator and equity markets thus are only free, fair, fast and efficient for liquidity makers and takers. Liquidity is vital to immediate trades, but not the fulcrum for capital formation or long horizons. Thus even the most ardent buy-and-hold investors – crucial to growing companies with long horizons – must behave like traders to generate returns in markets best suited to the production and consumption of liquidity.

If we're honest, the conclusion is clear. Regulations intended to make things fair for everyone have instead fostered an environment fit best for the high-speed short-term pursuit of price. In effect, we have transformed a capital-formation enterprise into a commodity market. We comment further on consequences and possible remedies at the end of our letter.

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To understand how we got here, it's helpful to retrace the regulatory path that brought us to the present fixation on price. First came Order Handling Rules requiring exchanges to display prices from alternative markets to help trading participants get the fairest price. Then decimalization sought to improve prices by shrinking spreads. Both efforts bettered execution prices. But consequent computerization also sped up transactions and shifted focus from capital formation to best transactional price.

Next followed the Spitzer Settlement separating research from trading and fostering new soft-dollar and commission-recapture rules. Investment in algorithmic architecture exploded. Sellside firms transformed from information providers to service bureaus helping the buyside navigate trading markets, manage risk and leverage yield from assets. Transactional speed rocketed. Trade-size declined.

Then came Reg NMS. With a defined best entry point for orders (with exceptions, we realize), Niagara Falls had to feed through a funnel. The obsession with transactions turned into ubiquitous and institutionalized high-speed machinery.

We've got what you'd expect. Sub-millisecond trading in equities and multi-asset-class global 24-hour automated algorithmic trading. Hedging with derivatives is de rigueur for institutions and prevalent among even retail traders. Often daily short volumes equal long trades as algorithmic systems try to balance supply and demand in accordance with the NBBO. We also observe the footprints of complex synthetics around equity trading, because the real supply of shares cannot keep pace with machine demand. Our average smaller client with market cap below $1 billion, trading less than 500,000 daily shares, is in 40 ETFs[ii].

Technological advancement is fine. But our markets don't foster capital formation or long-term investment. Equity indices stand near marks from ten years ago. Factoring for inflation, taxes and fees, investor portfolios held for the term have decreased in value by 30% or more. Derivatives have replicated like black-box algorithmic executions, producing a plethora of ETFs, CFDs, ETNs and all manner and mix of synthetics. But few new equity issues.

Meanwhile, trading is a profit cornucopia[iii]. From Barclays, to Bank of America, to Goldman Sachs, look at financial results from primary dealers. Underwriting produces modest revenue and few profits, but principal trading is a gold rush. Further, thousands of introducing brokers run fat trading operations with little more than a clearing relationship and a dab of working capital. From liquidity providers like Wedbush Morgan and Getco, to outsourced algorithmic solutions providers like Sungard's Assent, to arbitrage centers like Lime Brokerage, trading platforms have prospered and profited.

We're glad banks and traders succeed through entrepreneurship and technological innovation. By no means should we constrain them. But the trading constituency should not be advantaged at the expense of the issuers and investors core to vibrancy and sustainability.

Regulations are not the source of all market shortcomings. But regulations forced all three strands of market structure – trading, investing and managing risk – to behave the same way. Consequently, all activity has become a form of trading. This is not in keeping with the Commission's charter to foster fair, free markets for all participants.

Nor is it in the best interest of the investor-relations profession that we treat investment activity like commoditized trading and risk management. These do not have the same purpose. If debt instruments are valued efficiently in decentralized markets, equity transactions need not commoditize at a universal, constantly evolving price. It's not helpful to issuers. At a minimum we might move our rule structure away from its fixation on price and speed. Speed is fine and natural, but imagine forcing a distance runner to sprint the 100-meter hurdles.

The best way to discover how to fix markets is to let participants show you. Perhaps you might construct a pilot program with a small market of securities and the barest rules for trading. This voluntary test bed could mix a defined and limited variety of relatively unfettered participants, some who trade, and others who invest. Market behavior would naturally striate according to purpose and function.

After observation, the Commission could establish fewer and simpler rules that not only are easier and less costly to enforce, but which may be adhered to by all participants regardless of the sophistication of their systems, the size of their IT budgets, or their market purpose and horizon.

In sum, this Commission has an opportunity for extraordinary achievement. It could be the first in generations to cease applying regulatory epoxy to an environment now far removed from the intent of the Exchange Act. Capital formation should be our top priority, and regulations should fence out things that interfere with it. Without this vital functionality, in time our markets cease to have purpose.

It's time for a fresh, new and simple start that produces something with generational sustainability.

Yours very truly,

Timothy Quast
Managing Director

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[i] The Asset Allocation Advisor, November 2009. See here: http://www.aametrics.com/pdfs/world_stock_and_bond_markets_nov2009.pdf

[ii] Manual calculation from internal data compared against "ETF Insider" data from TheStreet.com.

[iii] We evaluated 2009 full-year financial results from seven "primary dealers," global banks with regulatory relationships to the United States Federal Reserve bank, and found that principal trading operations were by the far the largest contributor to consolidated profits.