25

TFS Capital

January 22, 2010

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

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OFFICE OF THE SECRETARY

Re: File No. S7-02-10, Concept release on Equity Market Structure

Dear Secretary Murphy,

TFS Capital is a twelve-year-old registered investment advisor that manages approximately $1 billion, primarily in long-short funds designed for retail investors. Since the end of 2008, we have publicly expressed concerns about many characteristics of the equity market's structure described in this concept release (see Addendum.) Since early 2009, TFS has also privately expressed similar thoughts directly to regulators. As such, we appreciate the Commission's broad review of the market's structure that is contained in the release. While TFS has thoughts on many issues contained in the release, we offer the following specific comments that we believe may add the most value.

Long Term vs. Short Term Investors – Many "long term" investors own equity mutual funds or other pooled products. Every time another investor buys or sells the same pooled product, the portfolio manager is forced to transact in the marketplace. As a result, such "long term" investors are affected by the market's structure regardless of their length of ownership.

Latency Arbitrage – The latency differential described on page 26 of the release causes unfair arbitrage opportunities to exist since many marketplaces rely on consolidated data to determine execution prices. Venues that are prone to being adversely affected by this differential are those that (A) offer low latency access to participants and (B) have large delays in implementing the consolidated data. Since conflicts of interest exist for those responsible for interpreting "fair and reasonable and not unreasonably discriminatory" as required by Rule 603(a) of Regulation NMS, I believe the Commission needs to change the existing regulations. It should do so with the goal of eliminating all latency differentials with the market's dispersed structure that offer risk-free arbitrage opportunities to high frequency traders.

Post Trade Transparency – The data collected on the post trade tape is inadequate to evaluate the quality of an execution since the events listed (i.e. executions and changes in the consolidated data) are (A) not in chronological order and (B) have timestamps that describe when an event was reported to the consolidated tape as opposed to when the event took place. The data reporting method should be adjusted to fix both of these issues. Furthermore, the measurement of time on the post trade tape should have precision that at least matches the speed at which the fastest high frequency traders execute orders. Otherwise, market participants will continue to have varying levels of transparency.

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Trend of Market Quality Metrics –TFS believes that traditional market metrics (e.g. volatility index) do not effectively measure the market's structure. Rather, important trends of the market structure could be gleaned by relatively new metrics (e.g. the number of marketplaces that exist, the number of such marketplaces that offer co-location services, the number of high frequency traders utilizing such services, and average latency of the marketplaces) over recent years.

If you would like to discuss our thoughts, I would welcome the opportunity to engage in further communication. I can be reached via electronic mail at Rich@TFSCapital.com or via telephone at (610) 719-8362.

Respectfully,

RICHARD J. GATES

Richard Gates
Co-Founder and Portfolio Manager

Addendum

1. **Wall Street Journal Blog**, December 26, 2008, Gaming in Dark Pools

   http://blogs.wsj.com/marketbeat/2008/12/26/gaming-in-dark-pools/

   One hedge fund manager says the only thing stopping him gouging clients of dark pools is his lawyer and his scruples. "It's free money," said Richard Gates, a portfolio chief at money manager TFS Capital. "It's a neat inefficiency in the marketplace, and dark pools are growing tremendously in size."

2. **Wall Street Journal Blog**, January 26, 2009, Playing Lifeguard in the Dark Pool?

   http://blogs.wsj.com/marketbeat/2009/01/26/playing-lifeguard-in-the-dark-pool/

   There are varying standards for calculating volume. Some firms double count when a trade is matched and executed in their dark pool. "It's incredibly misleading to double count volume and brokers don't proactively explain the volumes to people on the buy side," said Richard Gates, a portfolio manager at fund family TFS Capital who wants the SEC to put an end to the practice.

3. **Wall Street Journal Blog**, March 9, 2009, Measuring Arbitrage in Milliseconds

   http://blogs.wsj.com/marketbeat/2009/03/09/measuring-arbitrage-in-milliseconds/

   "You have tomorrow's newspaper today," said Richard Gates, a portfolio manager for TFS Market Neutral fund in West Chester, Pa., who looked into a latency-arbitrage strategy after a broker outlined the success other funds had with it. "You're looking at stale prices. Those are the types of investment strategies that arbitrageurs and hedge-fund managers drool over."

4. **Wall Street Journal Blog**, April 23, 2009, Enter the 'Ninja': Dark Pool Adjusts Speed for the Swift,

   http://online.wsj.com/article/SB124044887908246101.html

   "Most people who aren't ninja quick and don't have ninja skills will get creamed if they run into someone who is."

5. **Reuters**, June 15, 2009, Exchanges' anonymous trading sets off alarms

   http://www.reuters.com/article/newsOne/idUSTRE55E4R220090615

   "One of the things we should have learned in the last 24 to 36 months is that innovation in the financial services industry is not necessarily in the best interest of the average investor," said Richard Gates, portfolio manager of TFS Capital's $620 million market mutual fund.

6. **Forbes.com**, September 17, 2009, High-Frequency Trading And Mutual Funds, Is this the next market-timing scandal?

   http://www.forbes.com/2009/09/17/high-frequency-trading-intelligent-investing-mutual-funds.html

   [Gates said] rather than serving as market makers, my sense is that these firms are exploiting the rapidly evolving market structure and outdated regulations. The good news, though, is that the SEC said earlier this year that they were going to evaluate dark pools (which is one type of venue where a lot of these trades occur.) Moreover, Sen. Ted Kaufman from Delaware has taken to this issue in recent weeks as well. In fact, today he was scheduled to make a speech on this topic that is chock full of good stuff that you can view at: http://tinyurl.com/nm2dz9.

7. **Barrons**, October 26, 2009, A Fairer Stock Market for All

   http://online.barrons.com/article/SB125634705877105257.html?mod=rss_barrons_markets#articleTabs_panel_article%3D1

   Despite concerns that HFTs may be profiting by deliberately moving prices, Richard Gates, a portfolio manager at TFS Market Neutral Fund, thinks they're welcome because they create the trading volume dark pools need to survive.