The Uptick Rule

by Wade Young *on* March 12, 2008

The uptick rule is a former financial regulation that was eliminated by the SEC, effective July 6, 2007. Established after the great crash of 1929, the uptick rule was designed to restrict short selling by permitting short sales only following a trade where the traded price was higher than the previously traded price (uptick). Let's take a stock that was trading at $100 per share with the last two trades at $99.75 and $99.50, respectively. If you wanted to go short on that stock, you would need to wait for the uptick — until the stock went up from $99.50 to $99.75, for example. Then you could go short.

The uptick rule was in place to stabilize the marketplace, its job to keep the market from going into a downward, out of control spiral. It was also designed to prevent unscrupulous hedge fund guys from "pushing" the stock down by shorting, shorting, and shorting again. The uptick rule played an important role in warding off volatility in the financial markets.

Then everything changed when the SEC decided to throw the uptick rule out the window. On July 6, 2007 the uptick rule went by the wayside. Since then we have seen more volatility in the stock market. The average point spread between the S&P 500's daily high and low was 11.12 points in 2006 and 17.29 points in 2007. The point spread was 33.13 for the first month of 2008 alone.

What does this mean for the future? The abolishment of the uptick rule has most likely ushered in a new era of volatility in the financial markets with money moving back and forth between the stock and bond markets. And volatility in the financial markets translates into volatility for interest rates. Time will tell, but the elimination of the uptick rule will undoubtedly contribute to future market declines which, in turn, will affect the mortgage market.

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