Woodbine *Opinion*
Views on Issues Impacting the Capital Markets by the Analysts of Woodbine Associates
May 15, 2009

The Value of Short Sale Restrictions

On April 8, 2009 the Securities Exchange Commission (SEC) voted to solicit comment for restrictions on equity short sales. Under consideration are enhancements to Regulation SHO intended to buoy investor confidence in the currently turbulent equity markets.

Regulation SHO was adopted in January 2005 to modify the existing regulation on short sales originally adopted in 1938. The regulation was established to provide a framework for short selling including requirements for locating securities to cover shorted positions required for settlement purposes and closeout requirements in cases of extended fails. Amendments implemented in late 2008 incorporated anti-fraud provisions for abusive "naked" short selling.

The SEC is considering four alternative measures in regard to short sales including two approaches that would apply on a market-wide, permanent basis and two that would apply to a specific stock following a severe decline in price. The market-wide, permanent approaches include a market-wide short sale price test based on national best bid similar to the former NASD bid test ("Modified Uptick Rule") and a price test based on the last sale price (similar to former Rule 10a-1), on exchange traded securities ("Uptick Rule"). The security-specific, temporary approaches include two variations of circuit-breakers including a ban on short selling in a particular security for the remainder of the day following a severe decline in price ("Circuit Breaker Halt Rule") that could operate in place of or in addition to a price restriction, or a circuit breaker that triggers a price test on a particular security following a severe decline in price based on national best bid ("Circuit Breaker Modified Uptick Rule") or on the last sale price ("Circuit Breaker Uptick Rule"). Certain trades by market makers would be exempt from these restrictions if such trades were executed to enhance market liquidity or price efficiency.

Woodbine Associates believes that short sale restrictions, although disadvantageous for some, would be beneficial for the overall equity market. Specifically, we favor the implementation of permanent, market-wide tick tests combined with a security specific temporary short sale halt. We believe that such a combination would introduce "beneficial inefficiencies" to the market. Tick tests would help dampen volatility by removing some downward price pressure on securities brought about by high-volume shorting in the normal course of trading by low-frequency, high-volume "Black Box" trading strategies. Circuit breakers would halt trading in a particular security for a specified period following a severe price decline, likely triggered by unexpected, sensationalized, or incomplete news, giving market participants time to sort fact from fiction and more rationally incorporate bonafide information into value and price formulation.

We understand that price tests and halts may introduce inefficiencies into the market that would likely result in short-term stock price anomalies. In contrast, we believe that benefits brought about by investor confidence and orderly markets outweigh the economic costs of minute and temporary security mispricing.

We recognize that short sale restrictions will likely have more of an impact on Black Box traders than on traders using more traditional trading strategies and investors employing more value-oriented investment approaches. Black Box strategies generate returns using approaches designed to capture small margins on frequent, high-volume purchases and sales throughout the trading day. These strategies are most often technically-based and not associated with the analysis or projection of company performance to value traded securities. We acknowledge that these strategies have a place in the market although we consider them to be less of a contributor and sometimes an impediment to efficient market operations than strategies of traders representing “buy and hold” investors. We also have faith that the professionals behind the design of these black box strategies will find ways to incorporate any implemented short sale restrictions into their strategies and continue to operate profitably.

We also note that placing restrictions on short sales is not the same as eliminating them. Restrictions will prevent the unfettered short sale of securities, not prevent short sales. While restrictions may prevent a trader or algorithm from immediately selling stock on an event-driven basis, they will not prevent investors with a long-term directional view from assuming a short position. Investors with an unfavorable view of a company’s future prospects should and will have the opportunity to assume short positions in a restricted environment.

Efficient capital markets are essential for economic growth, development, and national prosperity. Well-developed primary and secondary equity markets enable the ready transfer of capital between firms and investors and the transfer of ownership rights among investors with differing views. Long-term investor confidence is paramount for ongoing efficient market operation and must be maintained to ensure this valuable component of our Nation’s economic engine continues to drive advancement. Properly implemented short sale restrictions should bolster confidence among investors, whose capital facilitates economic growth, by helping to ensure that markets operate efficiently, stock prices accurately reflect fundamental values of underlying companies, and the means for trading abuses will be further curtailed.

Woodbine Associates encourages you to learn more about short sale restrictions under consideration. Click here to visit the relevant section of the SEC website and click here to comment on the proposed restrictions.

Woodbine *Opinion*

Views on Issues Impacting the Capital Markets by the Analysts of Woodbine Associates

May 15, 2009

For More Information Contact:

Matthew Samelson
Principal
Woodbine Associates

(203) 569-1201

msamelson@woodbineassociates.com

About Woodbine Associates:

Woodbine Associates is a unique research and advisory firm serving the capital markets industry. Founded and staffed by highly experienced industry professionals, Woodbine Associates is raising the bar for quantitative, qualitative and survey-based research of critical capital markets topics by utilizing senior-level industry practitioners to dig deeper into the issues and render informed opinions and advice. In addition to a la carte reports, Woodbine's experts provide custom research and advisory services to the exchange, broker/dealer, asset manager, hedge fund and technology vendor communities.

For additional information: www.woodbineassociates.com