NATIONAL ASSOCIATION OF ACTIVE INVESTMENT MANAGERS

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

Re: File No. S7-08-09. Release No. 34-59748.
June 12, 2009

The National Association of Active Investment Managers (NAAIM) appreciates the opportunity to comment on the proposed rulemaking "Amendments to Regulation SHO" dated April 10, 2009.

NAAIM was formed in 1989 as a non-profit association of registered investment advisors who provide active money management services to their clients in order to produce favorable risk-adjusted returns as an alternative to more passive, buy and hold strategies. NAAIM has grown to include roughly 130 member firms nationwide, managing over $10 billion held in over 60,000 accounts owned by working people, retirees, trusts and others.

NAAIM is filing these comments out of concern that a decision to adopt this rulemaking as initially proposed may damage the portfolio risk-management strategies that are of value to a large, and increasing, number of individual investors and that are necessary tools for advisors whose fiduciary duty calls upon them to limit client risk.

We note that the Commission has proceeded with this rulemaking in advance of a full-scale report on the market decline, and perhaps as a result of proceeding quickly, consideration of the differences among types of securities is barely discussed; in fact exchange-traded funds were only mentioned once [in a question] in the entire 293 page rulemaking; closed-end funds not at all. Yet almost all equity-related investment instruments, including ETF's and perhaps closed-end funds as well, appear to have been rounded up under an expansive definition of "covered securities."

Rather than wait until there is a more complete assessment of recent events, the Commission has justified this rulemaking with the assertion that weak "investor confidence" and dangerous "market conditions" require it. The first part of NAAIM's comments will respond to that assertion; the second part will discuss the special character of diversified securities.

Investor Confidence and Market Conditions

In its rulemaking, the Commission suggests that short-selling barriers should be raised because of weak "investor confidence," and the Commission seems to find evidence of weak investor confidence mainly in the letters asking for restrictions on short-selling. Rather than getting bogged down in the circularity of that argument, NAAIM questions whether the current calls for short-sale restrictions can be fairly said to represent investor interests in general.

Just a little more than two years ago, only two individual investors in the entire United States filed comments opposing the Commission's proposed rulemaking to end 70 years of the uptick rule. Clearly, widespread short-sale opposition is not steadfast.

Fast forward to today and we read that over 5,000 petitioners, exhorted by an investor/television celebrity [1], and hundreds of letter writers, perhaps mostly marshaled in the same way, are calling for reinstatement of that very same rule.

What has transpired in the past two years? Did thousands of individual investors all of a sudden decide to school themselves in the micro-structure of securities markets, learning about the many and diverse facets of short sales?

NAAIM thinks not. The above-mentioned campaign to restrict short-selling instead demonstrates a few things: once again, the powerful influence of the electronic media; secondly, that many people who seek the returns of risky securities are too often not well prepared for the risk; and thirdly, the perfectly natural consequence of the S&P 500 falling peak-to-trough over 55% during a year-and-a-half period ending in early March [fortunately that decline has since diminished to less than 40%]. That these three factors have combined to raise some criticism of current Commission policy is not

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1] 24/7 Wall St., website article "Cramer and Over 5,000 Formally Seek Short Sale Changes," posted June 2, 2009. The Cramer is James Cramer, whose stock-picking show, "Mad Money" airs on CNBC.

surprising; people who have suffered a setback are often willing converts to an agenda promising a simple solution. [2]

The retirees, working people and other owners of the more than 60,000 accounts managed by NAAIM-member advisors also typically worry about stock market declines. They chose to act upon their concern in a different way [3], proactively hiring advisors who adjust their investment strategy to protect client portfolios at times when the market is going down or is otherwise of concern. NAAIM-member advisors achieve such risk reduction in a variety of ways, including diversification, tactical asset allocation, and hedging, buying inverse ETF's or mutual funds and shorting ETF's or other securities.

NAAIM-member advisors' own clients are only one illustration of the diversity of this country's investment population, many of whose members have long ago moved beyond the orthodoxy of the buy-and-hold, long-only strategy. Another good example of the diverse nature of the U.S. investing population is the growth of long-short mutual

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2] Perhaps the petitioners are also unhappy that someone made money in a declining stock market at a time when they were losing money. Regardless of the motive, it is clear that many are anxious to assign blame based on a limited possession of the facts - not the first time this has happened. As the Commission noted [pg. 20], "Many people blamed "bear raids" for the 1929 stock market crash and the market's prolonged inability to recover from the crash." Those people doing the blaming may have been guessing, and guessing incorrectly at that; the NYSE did not regularly collect data on short sales until May 1931. The most extensive work on securities during that period concluded, "The attention to short sales in the press and other commentary verged on sensationalism or a search for a scapegoat… When short sales data became available, however, many observers were surprised that short sales …were not the pervasive influence that many commentators looked for." Wigmore, Barrie A., "The Crash and Its Aftermath: a history of securities markets in the United States, 1929-1933", pg. 239.

3] NAAIM chose not to mobilize its advisors' clients to write letters to the Commission. We feel that many clients who hire our member advisors rely on them to, among other things, represent them on matters such as this before the SEC. The Commission already has on file letters from individual investors that articulate, for instance, their reliance on inverse ETF's: see, J D Freeman [April 23, 2009] and William D Dawson [May 6, 2009].

funds. Per Morningstar's Principia database, of the funds they categorize as "long-short," twelve were started before 2000; thirteen were started between 2000 and 2005, and 51 were added just in the last four years. Currently, such funds manage over $27 billion in assets.

In its rulemaking, the Commission has commendably detailed some of the many ways that short-selling is an integral part of investing activity. Unfortunately, the overall impression the rulemaking leaves is that "investor confidence" is sustained solely by the success of a buy-and-hold, long-only investment strategy. [4] NAAIM believes that investor confidence depends upon far more than a misinformed belief that investing is a one-way ticket to wealth, regardless of the state of the economy or the price of the security bought.

For the health of the capital markets, the most important kind of "investor confidence" is in fact confidence in the capital markets system itself. That confidence comes in part from trusting that the Commission will not skew the system to protect one investment strategy to the disadvantage of others. Indeed, it is the strength of the system, including a diversity of many investment styles, and not a long-only bias, which has allowed the securities markets to function well during the events of the past year-and-a-half.

4] Indeed, an entire academic discipline has grown up in recent years, documenting the irrationality of many investors, including their tendency to have too much confidence. Daniel Kahneman, who along with Amos Tversky, won the 2002 Nobel price in economics for documenting such tendencies wrote: "The combination of overconfidence and optimism is a potent brew, which causes people to overestimate their knowledge, underestimate risks, and exaggerate their ability to control events." "Aspects of investor psychology," Journal of Portfolio Management, Summer 1998 [co-author, Mark W. Riepe]. The level of today's investor confidence that the Commission seems greatly worried about may in fact provide a more realistic appraisal of risks and rewards in the stock market than the level of confidence two or three years ago.

As for "market conditions," there are many signs that investor confidence is already rebounding, [5] not the least of which is the markets themselves, where the stock market's snap-back from the trough and declining credit spreads suggest that the worst of the storm has passed, as do some sentiment indicators such as increased flows into equity mutual funds.

Investors are often warned not to invest by looking through the rear-view mirror. Similarly, NAAIM would urge the commission not to regulate through the rear-view mirror. [6] NAAIM believes that the limited understanding of the recent downturn requires caution before doing damage to the risk-management strategies used by many investors, and that neither current market conditions nor investor confidence justify any lessening of that obligation.

Diversified Securities

As stated in the introduction, NAAIM is concerned that the Commission's rulemaking fails to reflect the important distinctions that exist between individual stocks and

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5] "U.S. fund managers' exposure to stocks rose for a second consecutive month in May to their highest point this year," Reuters, May 28, 2009; "Stock Funds Take in Dollars for 12th week," Wall Street Journal, June 11, 2009; "Japanese retail investor sentiment about domestic stocks improved for a second straight month in May to its highest level in nearly two years," Reuters, May 26, 2009; "German investor sentiment surges to 3-year high," Reuters, May 19, 2009. NAAIM also wonders whether the assertion of dangerously weak investor confidence is consistent with the current willingness and ability of corporations to raise equity capital: "Wells Fargo & Co., ProLogis and more than 150 other companies raised $82.2 billion this quarter, beating the record pace at the height of the technology bubble in 2000, according to data compiled by Bloomberg." June 8, 2009

6] Unlike many of the supporters of short-selling restrictions, NAAIM acknowledges that it does not have the expertise nor access to sufficient facts to solve the complex question of short-selling's role in the overall market downturn, a task that presumably will take some time to answer accurately. We did note that the Commission itself cites only a "possible association" based on the work of only one researcher [pg. 20], who as it turns out describes his work as only "preliminary."

diversified investment vehicles such as ETF's and closed-end funds. Diversified investment vehicles, and the ability to short them, are especially important tools in risk management for individual investors and their advisors. NAAIM therefore also asks that the Commission incorporate the following recommendations into the final rulemaking:

Continue permitting the shorting of ETF's or closed-end funds without subjecting them unnecessarily to the uptick rule or similar impediments:

In its rulemaking, the Commission said a number of times that another motivation for this proposed rulemaking was to help curb the abuse of short-selling by those conducting "bear raids" on individual stocks. NAAIM supports the Commission's efforts to put an end to any fraudulent trading that seeks to damage the value of any individual company's security. We would note that neither ETF's nor closed-end funds are suitable vehicles for targeting individual stocks [7] and ask that the Commission exempt them from the list of "covered securities." [8]

7] Based on NAAIM's review of 450 equity-based ETF's, the number of stocks held in the median ETF is 108, making ETF's [long or inverse] hardly a suitable vehicle for conducting a surgical strike on the value of an individual company's shares. NAAIM guesses that the median holdings of closed-end funds is somewhat fewer, but still they are mostly, per the requirements of the Investment Company Act, diversified.

8] The Commission has asked [question 10, pg. 108] whether certain sectors or industries, notably the financial industry, ought to be given favorite treatment by erecting industry-specific barriers to short-selling. NAAIM notes that while there may be several thousand investors who have signed the petition concerning this rulemaking, the number of taxpayers who are upset about the special treatment propping up large financial institutions probably numbers in the tens of millions. A Maritz poll released just two weeks ago found that "people are angry that the financial industry required a bailout; more than half (55 percent) think banks are benefitting unfairly from the bailout and few (14 percent) believe banks are using the bailout funds to help solve the crisis." BusinessWire, May 27, 2009. While wishing neither to inject the latter topic into this rulemaking, nor to take sides on it, we do not believe the case has yet been made as to why yet more exceptional treatment should be granted to the financial sector or any other industry, by granting them special treatment with regard to short sales.

As long as there is no naked shorting of ETF's [an activity that we fully agree should be eliminated], NAAIM questions whether the shorting of an ETF would cause excessive downward pressure on the market since, as we understand it, [a] any excessive short-interest would have to be satisfied by the creation of more shares, resulting in an offsetting purchase of the holdings in the ETF, and [b] any significant discount to the NAV of the exchange-traded fund provides a natural arbitrage incentive for an institution to close the gap. [9]

Continue permitting the creation and efficient operation of ETF's that provide inverse exposure to various asset classes: NAAIM is aware that many such ETF's use swaps to effect their inverse exposure and may not short the asset themselves, however it is equally important that the investment banks and others that are counter-parties to the ETF in the swap have the option of shorting the asset themselves, if that is necessary to offset their own exposure. Thus, exemptions that permit counterparties to layoff such risk through the short-selling process and that are necessary for the operations of inverse ETF's should be allowed.

The health of inverse ETF's is especially important to the risk management of millions of retirement accounts that are not marginable and thus may have fewer hedging options. In general, NAAIM hopes the Commission will permit those ETF's, open-end mutual funds and closed-end funds whose mandate calls for them to hedge, to continue fulfilling their mandates to their shareholders, without raising obstacles that would make it difficult or expensive, the cost of which ultimately would be borne by those shareholders.

Sincerely,

Renee M. Toth
NAAIM President

9] The lack of damage to ETF's from shorting them probably explains why, of the two ETF sponsors that NAAIM had informal conversations with in recent weeks regarding this rulemaking, both said they had no objections to the shorting of their own ETF's.