Dear Mrs. Murphy,

Please do not reinstate any version of the uptick rule. Although placing limits on short selling may seem like a reasonable way to promote market stability, re-establishing the uptick rule will most likely lead to an increase in intraday volatility. The ability to short stocks on any tick is critical to prevent speculators from feverishly catapulting security prices higher and creating short term boom and bust cycles. When market rumors or breaking news send stocks higher, short selling is necessary to prevent excessive speculation and promote an orderly ascent. Otherwise, fervent buying can cause stocks to appreciate too much and too quickly. This sort of upside overextension often leads to a viscous sell off as short term speculators quickly sell their stock as soon as they believe buying momentum is waning. A price test rule would exacerbate this type of climactic buying and lead to erratic price movements that favor traders and speculators at the expense of institutional and individual investors.

In addition to instigating intraday price bubbles, establishing a price test rule for short selling would probably not significantly limit the magnitude or speed with which stocks decline. The SEC’s temporary ban on short selling among select stocks in September 2008 indicates that short selling restrictions do little to decrease volatility or arrest stock price declines. During the period when the ban was in effect, the Dow Jones Industrial Average fell 19% while an exchange traded fund that tracks the financial sector, the Financial Select Sector SPDR Fund, was down almost 26%. Under certain circumstances, legitimate selling activity can clearly cause large price declines without any short selling whatsoever.

Furthermore, a price test rule will undoubtedly serve to discourage the net short positions of market participants by making shorting more difficult. Reducing net short positions may reduce liquidity as investors who are short a security must ultimately buy it back. In fact, short investors try to cover their positions and buy back stock after a decline, which is precisely when there is likely to be the fewest buyers and the least amount of liquidity. Decreasing short positions, therefore, takes away critical buying liquidity when a stock is most vulnerable. While I also support an orderly and stable stock market, please consider that consequences of a price test rule for will likely increase volatility and make markets even more erratic than they are currently.

Sincerely,

Miller Kreider