In light of the tremendous outpouring of public sentiment indicating support for restoration of an “uptick rule” to regulate short selling activity in the equity markets of the United States, I wish to add to my previous comments submitted to the Commission on May 23, 2009 in response to *Amendments to Regulation SHO* File Number S7-08-09, (the proposal).

Clearly there has been a large public outcry to regulate and curtail short selling in U.S. equity markets. This response has certainly been a result of the consequential effects of the recent investment market declines that have been experienced since mid to late 2007, which in turn are reported to have destroyed investor confidence. Having read many of the comments submitted in response to the proposal it is clear that regulation of short selling including restoration of an uptick rule has become an extremely popular issue. It is also clear from the more than 5,600 comments received using Letter Type C that this has received more than the usual response due to the attention it has been given by the popular television celebrity, Jim Cramer of CNBC’s *Mad Money*, who appears to function as an investment advisor to the public at large.

It is also clear from the public comments made thus far to the proposal that the public at large has wrapped legitimate short selling activities together with abusive naked short selling. As I attempted to make clear in my previous comments on the proposal, legitimate short selling is a beneficial component of a normal and healthy marketplace. Naked short selling is abusive, is equivalent to fraud (selling something you do not have), and should be grounds for immediate and serious punitive action.

In adding to my previous comments I will first address the assertion made by many that “the former uptick rule protected and served investors well for 70 years”. Second I will address what must be considered “normal” equity market price behavior over time, the understanding of which is essential to establishing and maintaining investor confidence. Thirdly I will re-summarize the problems that must be addressed to rebuild investor confidence in the U.S. equity markets. Lastly, I will offer my thoughts on steps the Commission should take to restore investor confidence in the normal and healthy function of the U.S. equity markets.

HISTORICAL IMPACT OF SHORT SELLING WITH AN UPTICK RULE

A study of normal equity market price activity over the past eighty-five years as exhibited by the broad and well accepted S&P 500 index makes clear that U.S. equity markets regularly experience periods of significant and prolonged declines in price and value. Within the period of the former “uptick rule” the U.S. stock markets, represented by the S&P 500 index, experienced the significant price and value declines shown below in Table 1. This includes the period of the greatest single-day percentage decline in market value based upon that same index, October 19,1987.

Period	% Change in S&P 500	Duration
March, 1974 – October, 1974	-39.7%	7 months
August, 1987 – October, 1987	-35.4%	2 months
September, 2000 – September, 2001	-38.3%	12 months

These data reveal a typical rate of accelerated value decline within a deeper “bear market” of ~ 37.8% in nominally seven months. In the recent market period that has spawned the renewed call for restoration of an uptick rule, the S&P 500 fell from a high of 1576 in early October, 2007 to a value of 980 in early October, 2008 representing a 37.8% loss of value in twelve months. This shows that the rate of decline in the recent market period so much in question is completely consistent with historical norms during periods in which an uptick rule was in place.

A number of well researched studies have attempted to discern the impact of the former uptick rule and its elimination on pricing and volatility in U.S. equity markets (1-5). These studies have found that abnormal short selling was not correlated with price declines (1), that the former uptick rule was ineffective at achieving the objectives of short selling regulation, that concerns about increased volatility or degradation of pricing efficiency and liquidity were unfounded (2), that when an uptick rule is suspended short sell orders take place at a price that is, on average, above the quote midpoint (3), and that concerns about that the elimination of a price test would adversely affect market quality were unfounded (4-5).

Further a study by the Commission’s Office of Economic Analysis specifically examined short selling activity during the highly volatile period of early September, 2008 (6). That study concluded that, “results are inconsistent with the notion that, on a regular basis, episodes of extreme negative returns are the result of short selling activity.” Further it was found that “price aggressiveness of sellers who own the stock is higher than what is observed for short sellers”, and “in general, during periods of extreme negative returns, the sell pressure is more intense for long trades indicating that short sales put less pressure on prices than other sales during periods of extreme negative returns “.

Taken together, these studies and observation make it clear that legitimate short selling activities neither lead to increased market volatility nor do they bring about selling pressure that leads broadly to precipitous declines in equity pricing or market valuations. Moreover, the studies cited make it clear that a price or bid test does not deter or regulate legitimate short selling.

With these conclusions and historical market price/value behavior so evident, I am then led to confront the question, how can the re-implementation of a price or bid test for short selling justifiably restore investor confidence? When the fundamentals and the empirical market facts are properly understood, any restoration of confidence in equity markets that arises from such rules is misplaced and engenders nothing more than a false sense of security.

I submit that over the long term that little could be more injurious to investor confidence and, in turn, the capital formation process essential for economic health in The United States than a false sense of security that at some future point will be challenged and destroyed.

NORMAL EQUITY MARKET BEHAVIOR

A long-term consideration of historical equity market price behavior over time reveals what must be considered “normal” market behavior. Figure I included at the end of this comment shows a graph of the S&P 500 from December 31, 1924 through March 31, 2009 (7). These data show what is well known - that normal markets move between periods of increasing valuation and periods of declining valuation. It is well documented and understood in the investment advisory field that phases of increasing valuation over extended periods of time (e.g. “bubbles”) are followed by a comparable correction. The concept of *mean reversion* in stock markets is well established. Figure I. shows that the recent decline in stock prices since October 2007 is consistent with a reversion to the mean and is likely part of a correction or mean reversion that began in 2000. This is a key point that is largely missed by the public at large and the individual investor.

The data depicted in Figure I. also show that normal markets exhibit prolonged periods without appreciable gains but within which significant advances and declines take place. One such example is the period from November, 1961 through January 1975, over which the value of the S&P 500 ended nearly unchanged after fourteen years, but within which time there was an increase of greater than 66%. The period from September 1996 through February, 2009 (approximately 12.5 years) represents very similar period.

Broad public ignorance of what should be considered a normal, corrective decline from excessive price levels or valuations reflects the equally broad misunderstanding of both normal market behavior and the attendant risk associated with such behavior. If the investing public were better informed on the “normal” nature and movement of equity markets, they would likely be asking *how did prices and values become so elevated* rather than wondering why they fell so steeply. The investing public should have become alarmed in 1994 when prices moved above their normal boundaries and continued to do so is exponential fashion until 2000 and then again from 2003 into 2007 (highlighted area within Figure I.).

From the commentary to the proposal it is obvious that the investing public did not and still does not understand normal market price behavior. One obvious conclusion is that the investing public is participating in markets that pose significant financial risk without understanding either those markets or the attendant risks.

It should then come as no surprise to the Commission that the investing public has grasped the notion that short selling has destroyed market value that has been made popular by various pundits and celebrities who must have some motive other than dissemination of sound investment advice based upon an accurate understanding of equity market realities.

THE PROBLEMS

As stated in the proposal, the stimulus to reconsider regulating short selling is the "deterioration in investor confidence" brought about by "the extreme market conditions we are currently facing".

As the simple facts detailed above reflect, the market conditions that we are currently facing are not extreme. They fit well within historical norms during which the former uptick rule was in place.

However, broad investor confidence in market function is essential to the proper operation of investment markets and the capital formation process essential to domestic economic well being. Hence the Commission finds itself confronted both by public and political demand to take steps necessary to restore that confidence.

As the Commission considers its final action on the proposal it is important that it focus on the real problems:

1. preserving the merits and benefits of legitimate short selling,
2. eliminating abusive short selling practices, such as naked short selling which can be destructive to normal and healthy market function,
3. assuring that the investing public is properly informed on normal market behavior of the markets in which it participates and understands the associated risks,
4. assuring that the public is informed of investment strategies other than long-only, buy-and-hold that are appropriate during periods of significant or prolonged market declines

RESTORING INVESTOR CONFIDENCE

I previously submitted specific recommendations in my comments of May 23, 2009 on problems 1. and 2. stated above, and will not repeat them here. However, while the proposal did not did not specifically seek comments on the restoration of public confidence the fact that it is the motive behind the proposal renders the issue pertinent for further commentary.

In seeking to reverse the reported recent deterioration in investor confidence the Commission must guard against bringing forward ineffective regulation that will falsely create a sense of security within the investing public that this will not happen again. While this may be expedient in the short-term, it will likely prove more destructive in the long-term when it is appreciated that this too failed.

In seeking to promote increased investor confidence the Commission should consider increased regulation not of legitimate short selling but of those practices, advice and guidance that lead to prolonged periods of excessive valuations or “irrational exuberance” that ultimately must be corrected. It is during those corrective periods that the uniformed or unknowledgeable public experiences adverse financial impact and loses its belief in market integrity.

If the Commission seeks to take action to rebuild investor confidence that has been lost in U.S. equity markets it should direct its attention to broadly increasing and improving public understanding of the normal function and behavior of those markets, and to the typical risks that are associated with participation. This should include increased regulatory attention to the investment guidance and advice generally disseminated to the public through common investment institutions serving them (brokers, registered investment advisors, etc.) as well as investment vehicles broadly utilized by the public including mutual funds, 401k’s, 403b’s, SEP’s IRA’s, etc.

The Commission should consider regulations that would require all who provide investment advisory services to the public to include guidance on the selection and use of risk management products that can be employed to reduce or control the risk that come with normal market corrections and could benefit from typical declining market conditions.

In addition the Commission should consider regulations that would require all common diversified investment vehicles generally utilized by the public at large (401k’s, etc) to include and offer investment products that can be utilized to help manage or mitigate risks and provide the potential to increase in value during periods of market declines. These might include diverse short or inverse ETF’s, “bear funds”, etc. The mere presence of these within a list of investment options would serve well as a reminder of the risks associated with normal market participation.

CONCLUDING COMMENTS

In light of the tremendous public appeal for regulation of short selling there can be little doubt that the SEC feels significant popular and political pressure to act consistent with those requests. However, regulation in response to a public clamor, panic or political pressure when it would be inconsistent with fundamentals and empirical evidence, or it will not achieve the stated objective makes little sense and is potentially dangerous. I want to echo the comments made by Eric W. Hess on behalf of Direct Edge Holdings, LLC on March 30, 2009, that cautions against formulating regulatory response out of frustration.

In making its decision on the outcome of the proposal the Commission must remain steadfast in its reliance on factual and empirical market data along with well grounded research on the subject. The simple market facts and research reports cited herein make clear that the problem which must be confronted to achieve the Commission's objective is not legitimate short selling, and that the proposal will do little if anything to achieve the stated objective other than offer false hope.

I implore The SEC to rise above the public din for regulation that does not constructively achieve the objectives sought, including the Commission's stated mission to "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation". I also encourage the Commission to consider and take new steps that will ultimately and appropriately rebuild the investor confidence that has been lost.

Eric E. Bancroft
Individual Investor / Independent Trader
Lake Jackson, TX

cc: The Honorable Ron Paul, United States House of Representatives / May 23,2009 Comments attached

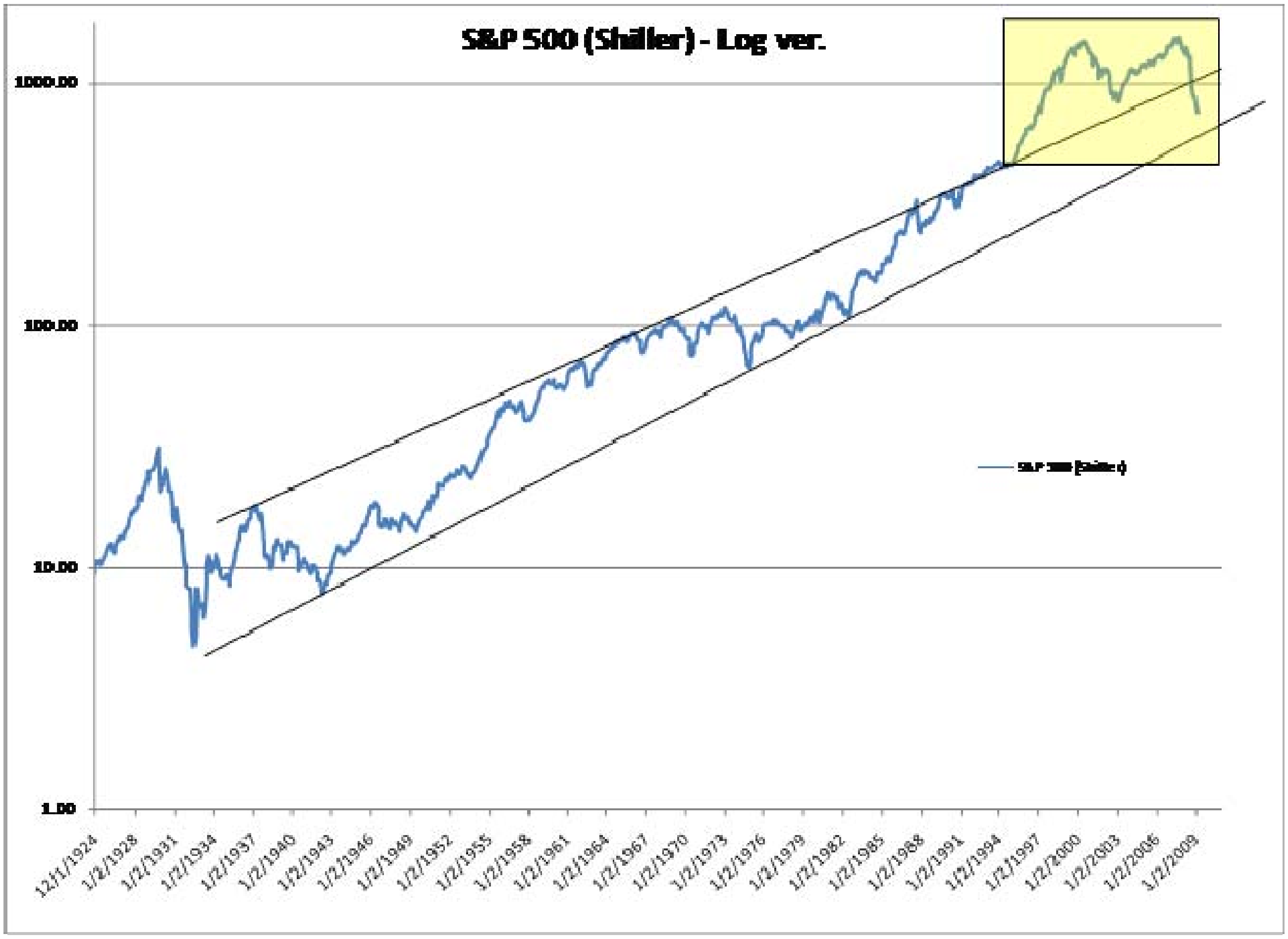

Figure I. S&P 500 for Period 12/31/1924 through 3/31/2009 (7).

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