June 8, 2009

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

Ref. File No: S7-08-09

Dear Mrs. Murphy,

I am writing regarding the reinstatement of the uptick rule. As a professional trader and a graduated Economics and Finance major from Princeton, I strongly advise against this reinstatement. The reasons for this are threefold. First, it has been proven time and again that short-selling constraints have no benefit for the market. Second, short-selling provides a very clear downside protection for long investors, and the idea of manipulation of prices to the short side is ludicrous, and laughable. Finally, short-selling provides a great amount of liquidity in stocks, and the removal of such liquidity would hurt both professional and personal investors alike.

Regarding the benefit of short-selling restrictions, it has been proven on multiple fronts that such benefits do not exist. The government's own recent studies have shown that the allowance of short selling does not affect, negatively or positively, the prices of an asset. Previous academic studies have all shown that limiting short selling negatively affects the price discovery of market assets. We can look at recent examples for confirmation of this fact. When the bank stocks collapsed due to multiple write-offs and our broken financial system, the government instated a temporary short selling ban of these stocks. The result? The financials sold off another 30% over the two weeks, and after the ban was lifted, sold off even more. This tells us that the sell-off was legitimate and caused by the market trying to price the assets at what they were worth (which, prior to adjustments of our accounting standards and the infusion of billions of dollars into the financial system, was at 50% or less of their current value). All that the short-selling ban was able to effect was a massive volume drop across the market and a delay in the accurate pricing of these stocks.

Next, I mentioned that short-selling provides downside protection for long investors. How is this possible? Just look at General Motors stock. How does a company, who has publicly declared bankruptcy and announced that equity holders will have their assets priced to zero, continue to trade around the $1 per share range for over a week? The only logical reason for such a phenomenon is that hedge funds and institutions are unwinding massive short positions. The liquidity on the bid caused by short covering just allowed "joe schmoe" investor who, without the financial knowledge decided to put his entire retirement savings in one of the oldest American companies, to salvage a large portion of his savings instead of losing it all. It is this fact, that short selling tends to be a shorter term strategy and that shorts at some point will always have to buy stocks, that creates a great amount of liquidity for long term investors to exit their investments in times of crisis.

Third, I said that manipulation of asset prices to the downside was ludicrous. This is understood inherently by any professional investor and the reason that the SEC itself has multiple broker regulations that need to be passed before a client can be allowed to short sell. Short selling carries substantial more risk than buying a stock. Due to the fact that there is unlimited loss potential every time you open a short position, anyone who opens a short position is exposing himself to massive risk. Because of this, we have multiple instances of the "short squeeze", where shorts are forced to cover and prices skyrocket. While similar price action can be seen on the downside in stock "panics", we see a fundamental difference in the two situations. Short squeezes (which, as a professional who does short stocks, I am very familiar with) can happen at any moment, for no reason whatsoever. It is a commonly accepted principal among traders that the biggest up days in the market are always in a bear market. This is because, even though the market tends to belong lower and lower in these situations, as soon as the market gets a whiff of large short positions buyers will step in and force the shorts to cover. On the other hand, stock "panics" (where stocks sell off massively) tend to have a sound reason behind them—the technology sector collapse in the early 2000s was due to the fact that dot coms made no revenues, the financial collapse last year was due to billions of dollars of writeoffs, etc. As you can see, for a trader, or a firm, to depress prices purposefully through shorting would involve such a degree of risk that it is highly unlikely (and should the market find out, that trader/firm would very handily get squeezed).

Finally, short selling offers a good deal of liquidity in the market. Especially in instances where all stocks belong lower (it would be naïve to believe that all stocks should only go up), and even in instances where the whole market is going up, short selling provides bids and offers whose absence would prohibitively increase the cost of investing (the spread) for your average investor, and decrease the number of trades made by professional investors (thus decreasing liquidity even more).

As you can see, there are multiple reasons to allow short selling, and not one to reinstate such an antiquated and harmful rule such as the uptick rule.

Sincerely,

Billy J. Liu