

Survey Finds Trading Strategies Change As Decimalization Adversely Impacts Market Liquidity And Transparency

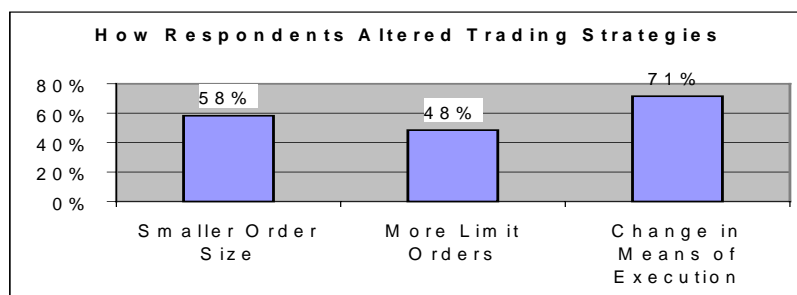
Summary

In August 2001, Midwood Securities, Inc. conducted a survey of more than 600 senior traders from institutional investment management firms with assets under management ranging from \$500 million to more than \$700 billion. Responses were received from 15% of those surveyed. The intent of this survey was to develop a composite of the traders' views on the impact of the change to decimals.

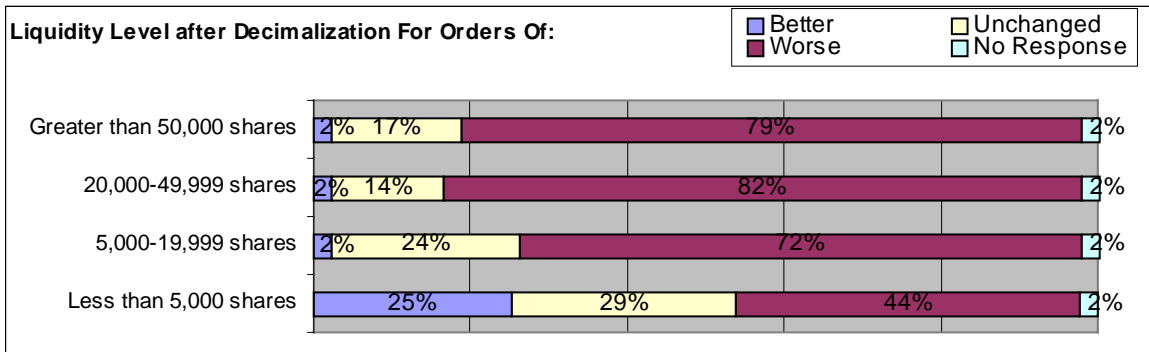
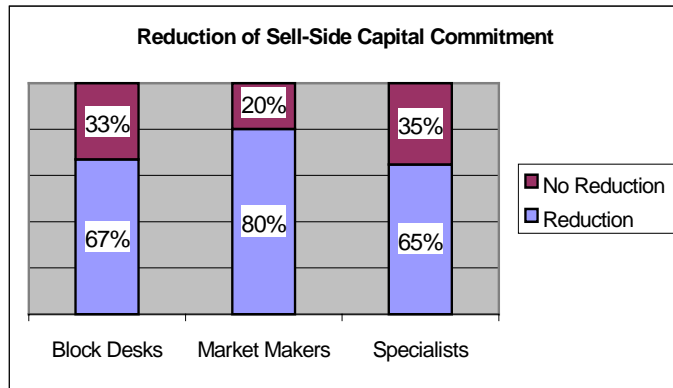
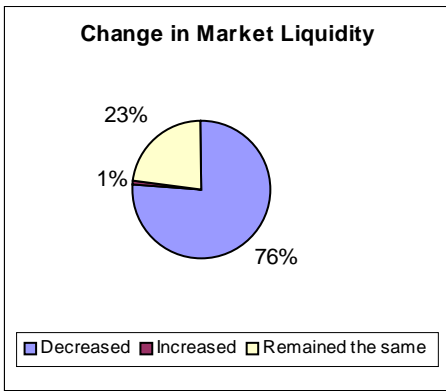
- More than 75% of respondents indicated that they have **altered trading strategies because of decimalization.**
- Three-quarters of the respondents believe **market liquidity has declined and market transparency (the depth of price information readily available to all market participants) has been negatively affected,** with a corresponding **detrimental impact on execution quality.**
- Almost 80% of the respondents report a **change in volatility,** of which more than 90% see the change as **not beneficial** in executing transactions on either the NYSE or Nasdaq.
- More than half of the respondents report an **increase in trading costs,** of which two-thirds say **market impact (the degree to which an order affects the market price) was the major contributor.**
- Almost 80% of those who responded **do not consider a change of \$.01 in the bid or offer to be price improvement** and 60% believe **\$.05 should be the minimum price improvement required** for specialists and market makers who want to outbid a limit order. Almost 70% believe the **minimum price improvement should be available to all market participants.**
- More than 50 percent of the respondents favor **NYSE rule changes to increase the minimum price improvement necessary to break up an agency or principal cross.**
- Approximately 80% of the respondents believe **specialists benefit the most** from the change to decimals and two-thirds believe **institutional clients benefit the least.**

Findings

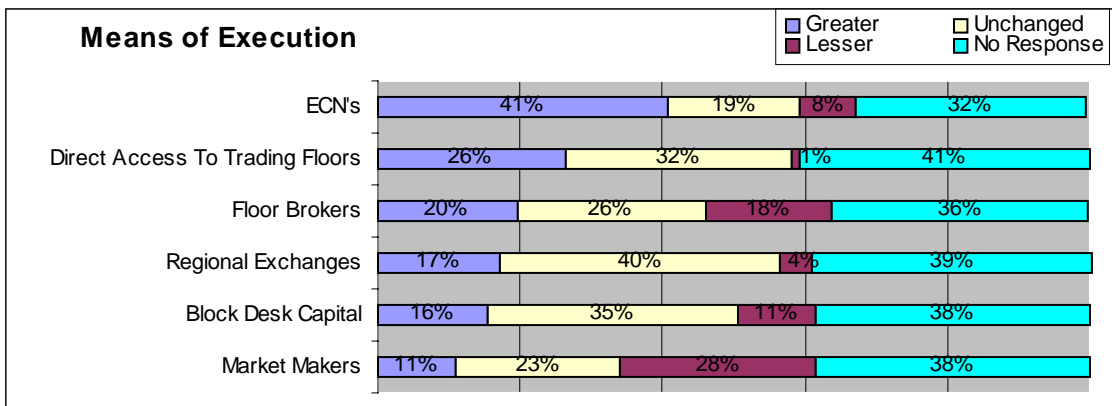
- Decimalization has caused traders to reassess the way they execute orders. More than three-quarters of those who responded have altered trading strategies.



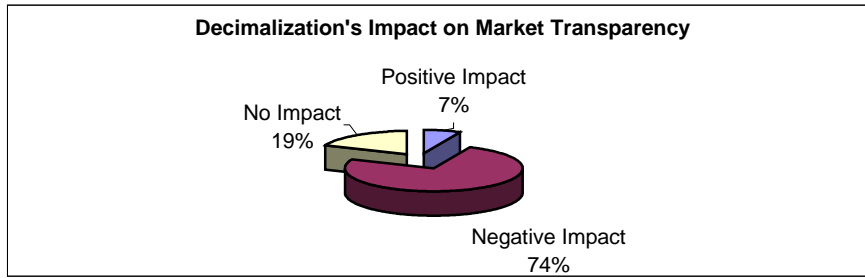
- More than three-quarters of the respondents report a decline in market liquidity and a reduction in sell-side capital commitments. More than 70% believe the reduction in sell-side capital will negatively impact the quality of execution.



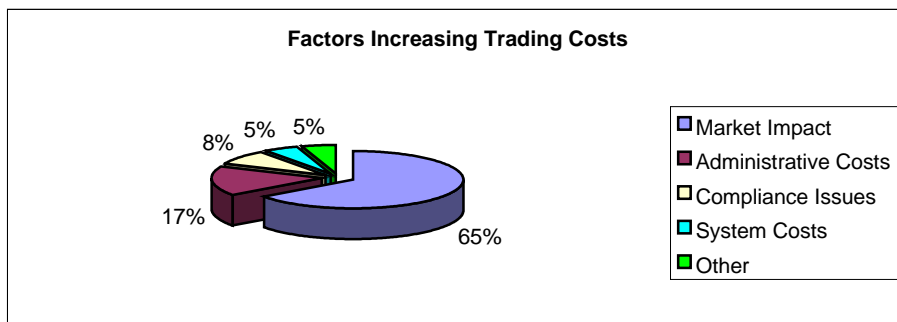
- As sell-side capital commitments have declined, traders are using alternative means of execution. Respondent use of ECNs shows the greatest increase, while respondent use of market makers shows the largest decline.



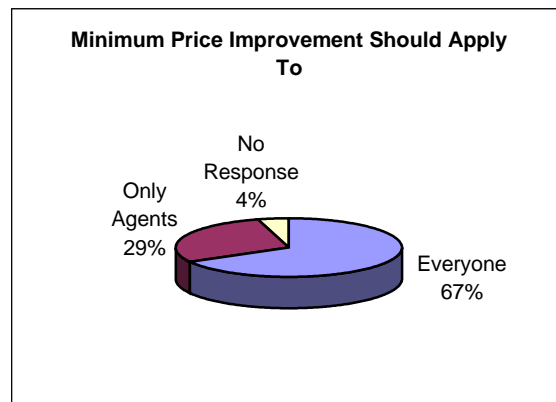
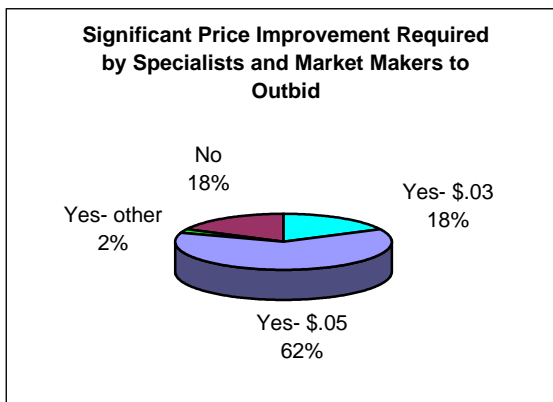
- The increase in the number and frequency of stock quotes as a result of decimalization has reduced market transparency. Almost three-quarters of the respondents consider this negative.



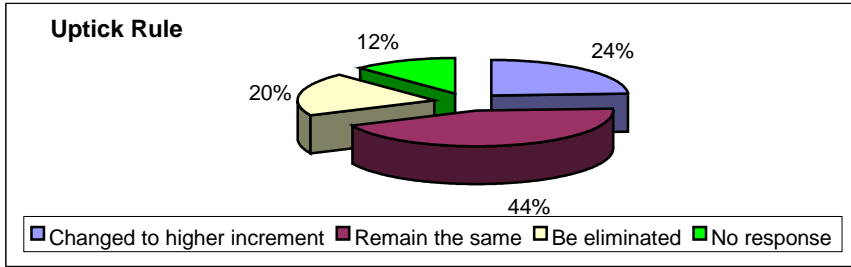
- Almost 80% of the respondents report a change in volatility, of which more than 90% see the change as not beneficial in executing transactions on either the NYSE or Nasdaq.
- More than 50% of the respondents report an increase in trading costs.



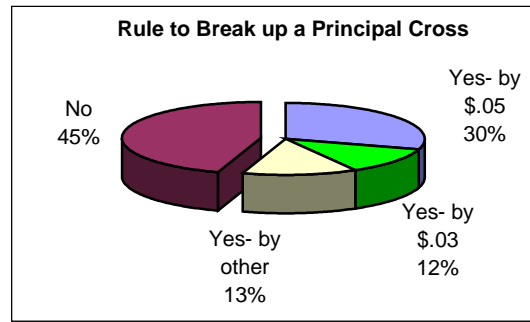
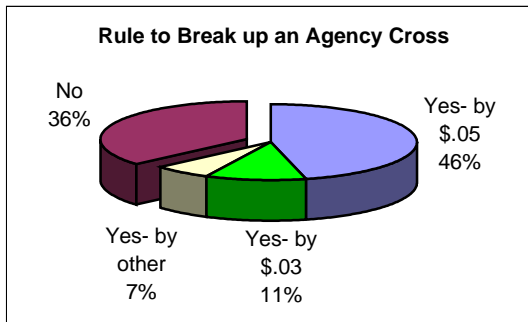
- More than 80% believe specialists and market makers wanting to outbid a limit order should be required to offer a significantly better price. Almost 80% of those who responded do not consider a change of \$.01 in the bid or offer to be price improvement. Two-thirds believe all market participants should be permitted to improve a quote by the minimum price increment.



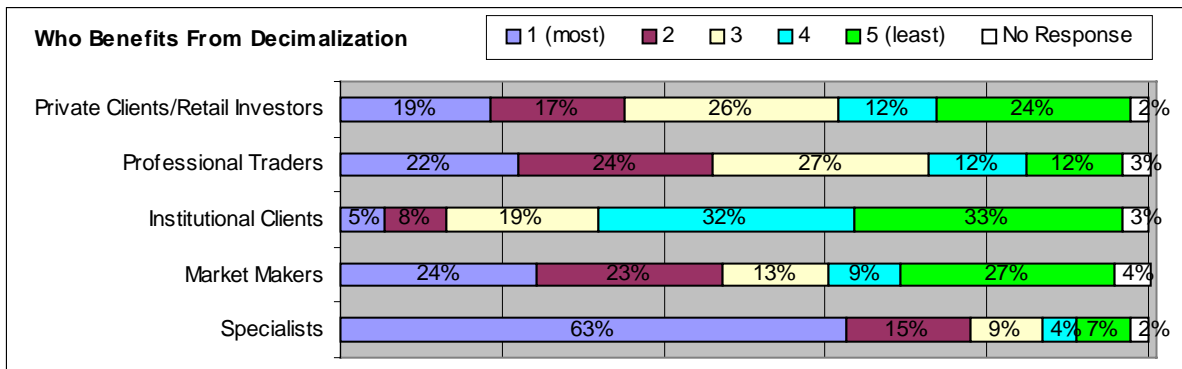
- In a decimal trading environment, the greatest percentage of respondents believe the “uptick” rule for short-sales should remain the same.



- More than 50% of the respondents say they would favor a NYSE rule requiring a minimum price improvement of more than \$.01 to break up an agency or principal cross.



- Most respondents believe specialists benefit the most, and institutional investors benefit the least, from the change to decimals.



For further information regarding this survey, please contact Midwood Securities, Inc., (212) 742-9600

Midwood Securities, Inc. is a New York Stock Exchange and NASD member firm specializing in serving the institutional investor.

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