

MARKET PERSPECTIVE

Turning the corner:

Since the SEC's ban on new short sales of financial stocks expired last week, are short sellers returning to place their bets?

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Short selling activity in US financial stocks declined significantly during the two and a half week ban, but new data show that trend might be turning the corner.

The SEC's ban on short selling financial companies' stocks led to a significant decline in the amount of short sales, as evidenced by a 47% reduction in the number of shares borrowed by short sellers and others in the securities lending market (see Chart 1).

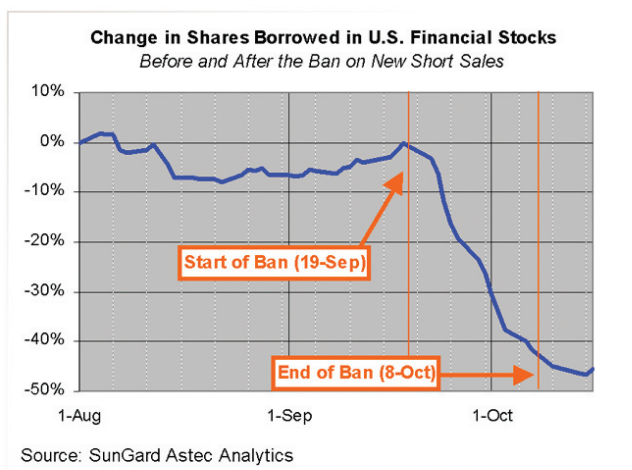


Chart 1: Trends in shares borrowed in U.S. financial stocks since 1-August

According to this data, which is tracked daily by SunGard's Astec Analytics research group, the SEC's ban seems to have had the regulator's desired effect of reducing short selling activity in the financial stock sector. On October 18, more than 4.14 billion shares of these financial stocks had been borrowed by institutions, such as those hedging exposure to a shaky financial sector or others betting on further price declines. But the SEC's ban on new short sales – perhaps along with redemptions and other needs to raise cash – seems to have forced many to unwind these short positions and return their borrowed shares. On October 15, there were just over 2.2 billion shares of these U.S. financial stocks still on loan.

To some, this reduction in short selling activity would represent pent up desires to book new short trades once the ban expired, whether to hedge weak-looking long positions, or to express a view that the share prices for some of these bank stocks were overvalued. That may or may not be true, but once

the ban has expired, we saw that some short sellers continued to sit on the sidelines for a few days – this time by choice, rather than regulation.

However, the newest data on securities lending trading data from SunGard Astec Analytics shows that yesterday, October 16, the number shares borrowed for the previously protected financial stocks increased for the first time since the SEC prohibited new short sales. The number of shares borrowed by short sellers and others in the stock loan market for these financial equities rose 2.2% from Wednesday to Thursday, although there are still 45% fewer shares borrowed compared to September 18.

Although yesterday's trading activity revealed a net increase in the amount of short selling and consequent share borrowing volume in the market, stock-by-stock data show that not all firms are yet facing increased shorting demands. As seen in Table 1, only 47% of the U.S. financial companies that were on the "no short" list saw more of their shares borrowed yesterday, suggesting that several of these companies saw relatively large increases in short sales. Another 38% of the U.S. financial companies experienced less demand to borrow their shares, while about 15% of these firms saw essentially no one-day change in shorting sentiment.

The continuation of the downward trend in the number of shares borrowed in the financial sector immediately

after the ban expired could be a reminder that prices, which fluctuated widely in the past several days, are not dictated by short sellers, but rather by company fundamentals and wider market sentiment. Although we are just now starting to see an increase in share borrowing activity, the fact that short sellers have not returned en masse could suggest that many investors who usually engage in short selling as part of their investment strategy might be expecting the market to reach a bottom soon. Or then again, it might reflect the fact that many such investors are in need of cash for purposes other than short selling right now.

Whatever the reason, the downward pressure on shares borrowed for short selling U.S. financial stocks appears to be subsiding. Are we turning a corner? It remains to be seen in the days and weeks ahead. SunGard will continue to monitor the changing securities lending market day-to-day to track if and when short sales activity returns to previous levels.

Table 1: Percent of U.S. financial company stocks whose shares were borrowed more or less on Thursday, October 16.
Source: SunGard Astec Analytics.

From Wed to Thurs	Percentage of Stocks
LESS BORROWING	47%
MORE BORROWING	38%
NO CHANGE	15%

About Astec Analytics

SunGard Astec Analytics is a research company specializing in market information services for the global securities lending industry. Astec Analytics services also integrate with SunGard's leading solutions for US and international securities finance, including the Loanet, and Global One realtime multi-currency solutions for international securities lending and Martini, a real time trading platform for bond and equity securities financing.

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