

The Active Manager



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SEC's Proposed Amendments Signal a Shifting of Audit Costs to Advisors

ERIC CLARKE, PRESIDENT, ORION ADVISOR SERVICES, LLC

NOTE: The SEC wants your opinion to help guide these regulations. Comments on the proposed amendments are due by July 28, 2009.

ON MAY 14, 2009, THE SECURITIES AND EXCHANGE Commission (SEC) proposed changes to the custody rule under the Investment Advisers Act of 1940, Rule 206(4)-2, which will affect investment advisors who are deemed to have custody of client assets. This definition encapsulates advisors who have custody of client accounts either directly, through affiliated custodians, or by virtue of being able to take fees from client accounts.

The proposed changes affect more than 9,600 advisors who have the authority to deduct fees from custodial client

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President's Letter



Renee Toth

“IT WAS THE BEST OF TIMES, IT WAS THE WORST OF TIMES...” WHILE THESE times aren't exactly revolutionary (though some pundits would argue otherwise), they are exciting, challenging times. Plunging markets that left investors breathless with investment goals pushed back, contrasted against the stellar results of those investors lucky enough to have a NAAIM member manage their assets. Amazing times, indeed.

It is my honor and humble privilege to be handed the leadership of this wonderful organization by Will Hepburn, who for the last year has set very high standards for innovation, creativity and just plain perseverance. Will has been an inspiration, and I thank him on behalf of myself and NAAIM for his tireless dedication in promoting the goals of its membership. I couldn't have had a better role model.

So, what's on the horizon for NAAIM? The Board of Directors and officers are on a mission to reach out to the membership, offering lots of new opportunities to get involved in the growth and services of the Association. Because when we look at member retention rates over the years, we find that members who are engaged by participating on committees, sharing on NAAIM's Online Forums and contributing articles to *The Active Manager* tend to stick around. It's that old adage (I love old adages, don't you?), you only get out of something what you put into it.

Members shouldn't be surprised to receive a call in the coming weeks from a Board or committee member inviting them to take their place on a committee. Membership Services, Retention and Marketing are always looking for fresh ideas. And, a newly-formed committee begging for help is the Regional Meetings Committee. Tom Hamilton, here in my backyard in Birmingham, Michigan, is the chairman. His Perrysburg Roundtable group, made up of about 20 NAAIM members in Michigan and Ohio, has been wildly successful creating the model that we hope to duplicate across the country to serve existing members and recruit new ones.

Speaking of recruiting, finding like-minded active advisors to join NAAIM will be a serious focus this year. It's hard to imagine a more perfect market environment to solicit new members, and NAAIM will be publicizing several initiatives begun by Will and the Board last year to capitalize on the Association's mandate. Among them, the Achievements in

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The New Model: Inter-Market-Broker

JAY BERKMAN, PRINCIPAL, JLC GROUP

MANY BUY SIDE TRADERS/PM'S THAT BEGAN their careers on the "sell-side" and have traded OTC fixed income products are well-aware of the integral role played by inter-dealer brokers, or "IDB's". These agency-only intermediaries have a long tradition of not only facilitating orders directed by institutional customers to their respective 'primary dealer', but IDB's provide sell-side constituents with crucial price discovery and trading market transparency in otherwise non-transparent markets.

Aside from providing "whole-sale market" pricing levels, IDB's are called upon to source liquidity in cases when the primary dealer might not have inventory to fulfill a particular order, or simply may not be inclined to trade at risk by "taking the other side" of a customer's order. The IDB's not only connect to the universe of competing sell-side dealers and traders that would have an "axe" in the particular name, but these brokers necessarily preserve counter-party anonymity.

Within the exchange-listed, "screen-based" product arena, which include not only equities, but equity options, index products, and ETF's, buy-side managers are accustomed to directing orders not only to their prime broker, but might also enlist institutional "agency-only" broker/dealers, who in turn connect to the related exchanges.

That said, as exchange-traded hedging products continue to attract exponentially-increasing capital flows, the preponderance of liquidity pools and trading centers, numerous "open" and "closed" transaction systems, and the growing number of competing and complementary market-making participants, has made these *seemingly* transparent, screen-based markets ever-more fragmented.

Consequently, buy and sell-side traders focused on these "direct access" products are faced with the challenge of efficiently sourcing *optimal* liquidity and *best* pricing for large block and hard-to-execute trades. For many, that challenge is readily addressed by *inter-market-brokers*; exchange-traded product specialists that seamlessly connect to multiple market centers *and* the wide array of participants within the trading market ecosystem; a universe that transcends the typical walls that separate buy and sell-side players.

One example of this new breed of agency broker is New York-based execution boutique WallachBeth Capital ("WBC").

The firm's team of former equity and listed option market-makers, prop traders, and exchange brokers sit on top of the walls that separate market participants. With electronic interfaces to major exchanges and ECN's, and open-line connections to sell-side facilitation desks, exchange floor traders, off-floor market-making firms, and buy-side managers that include RIAs, hedge funds and traditional PM's, WBC is the Switzerland within a highly competitive trading world, providing neutral, unbiased services to *all* of their constituents.

"The fact is, however pervasive trading screens have become, they're rarely three dimensional, and there will always be pockets of liquidity and better pricing that are simply not exposed on those screens...."

"The fact is, however pervasive trading screens have become, they're rarely three dimensional, and there will always be pockets of liquidity and better pricing that are simply not exposed on those screens. Accessing the real liquidity and discovering the best pricing requires picking up a phone or sending someone an instant message," said David Beth, Co-founder and President of WallachBeth.

Added Beth, "Many trades, whether initiating or closing, don't or shouldn't require split-second execution. That's when a sell-side PB facilitation desk or a buy-side hedge fund trading desk will contact us directly. They know that best fills, as measured by execution price, market impact and execution cost are secured by shopping around."

The true value of firms such as WBC is apparent not only because inter-market brokers are often the defacto color commentators of the internal market place, but because they are product specialists that are uniquely positioned to facilitate the execution of a large block trades, a complex spread, or a thinly traded ETF, often within the market's prevailing bid/offer quotation.

Jay Berkman is a 20 year securities and options market veteran, and currently a principal of JLC Group, a marketing/business development boutique. A former member of the CBOE, Amex, and NYSE, Berkman played a senior role in the development of BondNet, a pioneer electronic trading platform for corporate bonds, and he has advised, amongst others, Bank of New York Mellon, high yield bond firm Miller Tabak Roberts Securities, Interactive Brokers, and energy trader MBF Clearing Corp.