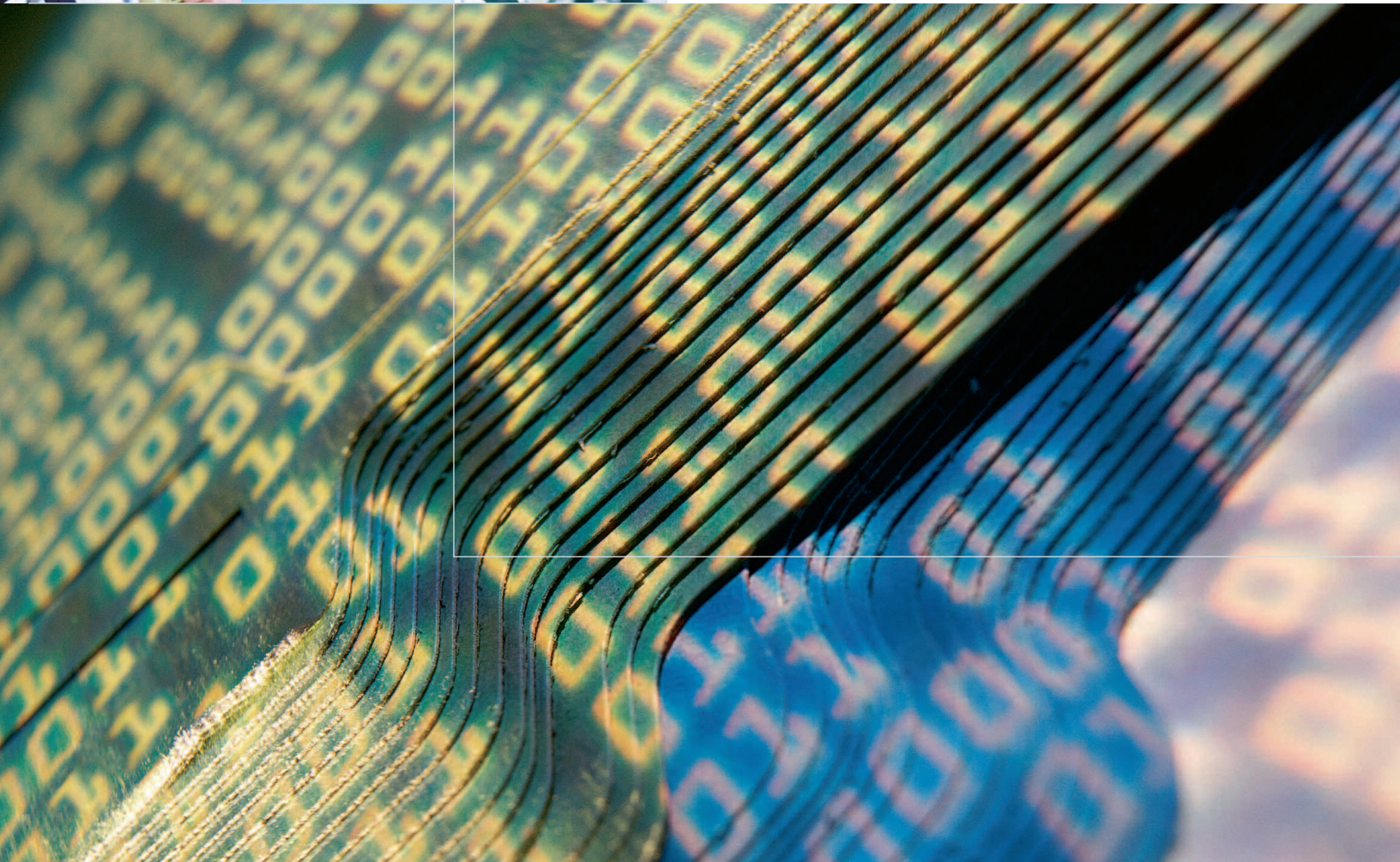


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Best Execution

Industry Leaders Address
the Search for Best Execution



A Supplement to

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Best Execution '06

Industry Leaders Address the Search for Best Execution

Complexity Demands and Drives

Latent demand is an often-overlooked source of liquidity. It's difficult to detect and to exploit, and only the most astute brokers are capable of consistently surfacing and executing such transactions. Among them: JonesTrading, an agency-only brokerage with a 30-year history of adroitly handling complex orders for clients.

JonesTrading's success lies in its unorthodox approach. Its singular focus on executing large, complicated orders through its trader-based crossing network enables it to excel. Its structure — traders dispersed across 12 offices — frees it from typical Wall Street constraints, giving the firm unique perspective that helps it achieve best execution on its specialized trades.

Kevin Callahan, JonesTrading's Managing Director and National Sales Manager, explains.

"We want to be the shortest distance between a buyer and a seller."

What's the JonesTrading approach to best execution?

JonesTrading specializes in executing larger and more complex orders for its clients with minimal market impact. We view best execution as helping clients achieve their investment objectives by getting the price they want, the size they want at the time they want it. We do this in a way that's difficult for others to achieve.

JonesTrading is a proactive, liquidity-sourcing network. We seek out liquidity as opposed to just responding to orders sitting in a system. It's amazing how many times portfolio managers and traders will respond favorably when an opportunity is presented to them.

Most passive networks cross only a small percentage of orders, typically in the single digits. JonesTrading consistently crosses more than 40 percent of the orders that we touch. It is our experience that most accounts want to appear passive, when they really have active intentions. That's when we come in.

How does that unfold?

When someone calls JonesTrading, they're not just dealing with a person or a broker. They're accessing a network of 80 traders who have relationships with 1,000 different top-tier clients. Our competitors have chosen to relegate perceived less-important accounts to "middle markets." At JonesTrading all of our clients are important. Having said that, there are some accounts that we choose to avoid. We don't have to do business with everyone and we prefer it that way. We essentially help our network of clients trade with each other, bringing buyers and sellers together in an anonymous, trusted environment that has been tested and proven over a 30 year period.

When an order comes into JonesTrading, it's not going to a big trading floor. It's going into a very tightly controlled network. Our head trader oversees the orders flowing over our network of small offices, each of which is run by a highly experienced branch manager. We have 18 former heads of desks at JonesTrading.

This structure enables clients to get things done within JonesTrading that they can't get done anywhere else.

What characterizes JonesTrading's clientele?

We bring together a diverse mix of clients to help them trade with each other. Our heterogeneous trading community includes large, traditional value managers; momentum players; growth players; distressed players; arbitrage players, long/short, a wide variety of investment strategies. They each have different perspectives on the market, which translates into trading opportunities.

Consider this: when there's a company going through difficulty, value managers want to get out and distressed players want to come in. With the skill of two JonesTrading sales traders working together, there is one agenda: the customer's. Without outside agendas, we achieve best execution and they can get those trades done in the most advantageous way for both parties.

How do you avoid information leakage?

The bedrock of JonesTrading's entire business is allowing absolutely no information leakage. Every day we live and die



Kevin Callahan
Managing Director and National Sales Manager
JonesTrading

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by the work that we do for our clients. Everyone in our network knows that information leakage would cause the network to break down. Clients wouldn't do business with us if we allowed such irresponsibility. Nothing could possibly be more motivating.

Other factors contribute to our success on this front. The way we're structured helps prevent information leakage. First, every customer has a single point of contact at JonesTrading — an experienced trader who manages a complex trade from beginning to end. Second, JonesTrading is owned by traders and run by traders. As employee-owners our traders are incentivized to protect our franchise. Protecting the franchise means that calls not made are just as important as call made. In other words, our employee-owners are incentivized to protect the orders we have, not the orders we don't have. Third, our model has no conflicts. There are no footprints before or after the trade. Our customers are "clients" not "counterparties." We do not engage in proprietary trading. We are a pure agency broker that has one business principle: Our clients' interests always come first.

We tell clients, trust us but also measure us — and we'll stand up to it. Quarter after quarter, JonesTrading comes out No. 1 or 2 in Plexus rankings. We are tops in terms of executing large orders and in executing less liquid names. We also provide one of the fastest, most transparent, efficient execution platforms to any market. Liquid or illiquid, large or small, our platform is in place for the customer only.

How do you survive despite an ever-growing array of state-of-the-art tools?

The challenge for the buy-side desk is aligning its trading strategy with its investment strategy and then aligning its trading strategy with the dynamics of the marketplace. That's where an array of tools helps deal with those market dynamics and helps get best execution and, in the end, achieve the investment objective.

Any time a new tool comes out, whether that's an ECN or a passive crossing network or an algorithm, the initial reaction is to assume that tool can solve everything. The history lesson of the last 30 years on Wall Street is that there is

no silver bullet. You need a variety of tools in order to achieve best execution.

Sophisticated customers with a well thought out way of choosing how they source liquidity will choose JonesTrading — but not for everything. We don't want to be all things to all people. We recognize there's an array of tools that the buy-side has access to. A lot of those make sense. We are another tool. We are a proactive liquidity-sourcing tool they turn to for certain types of orders.

JonesTrading adds value in a way that no one else can. We're the largest independent agency-only liquidity platform. We want to be the shortest distance between a buyer and a seller. We help our clients manage the complexity frontier: The larger the order, the less liquid the stock, the more volatile it is, the more adverse the momentum, the more relevant JonesTrading becomes.

JonesTrading does equity trading on an agency basis, and that's it. My experience in business is that if you do one thing, you're likely to do it better than anyone else.

What does the future hold for best execution?

The way our clients are measuring best execution is getting more sophisticated every day. The regulators support a transparent market and, more importantly, the buy-side is demanding it. Understandably, buy-siders want to know exactly what they're getting for their money.

Initially, there was a tendency to focus just on the explicit cost of execution, mainly commissions. Then, many buy-side customers began looking more closely at the total costs of execution, including the costs of market impact, the opportunity costs of delays, and the hidden costs that can result from using sell-side capital to facilitate trades. Now, some customers are leading the way in taking this to the next level: they are looking at execution not as a cost center, but as an integral part of boosting investment returns.

We like that trend because we clearly add a lot of value to our clients. We add basis points to the portfolio. We help them achieve their investment objectives and increase their investment returns. We support a world that's transparent because we add value and we have the numbers to back it up. ❖

Outsize trading

Elephant trades done well—those outsized relative to their daily volume range at *all* cap levels—significantly add alpha to your portfolio as a whole. JonesTrading is the designated location for the difficult trade. We are a human crossing network with scale, the perfect counterpoint in a market distorted by proprietary venues and market fragmentation. For over 30 years we have built a culture to get it done. Our transparent model provides the open forum for clients to connect their extraordinary liquidity needs. *JonesTrading. For trade completion that leaves VWAP behind.*

JonesTrading Institutional Services LLC. Member NASD, SIPC.
For more information, call Packy Jones at 818 991 5500. www.JonesTrading.com

JonesTrading
Quietly Moving Mountains.