

December 26, 2004

Mark Schurter
Pacific Exchange
Tel:
Fax: 312 442 7778

Re: Novastar (NFI) trading irregularities on 12/22 and 12/23/2004, updated

Dear Mr. Schurter,

You returned my call earlier today, thank you kindly. As promised a letter describing what I was trying to say. I am writing about what I believe to be blatantly illegal stock manipulation of Novastar Stock (NFI), which occurred on 12/22 and 12/23/2004.

Novastar is a mortgage company (M-REiT) with outstanding management and business model, and has excelled in building its business over the past years. Since about 2002 the stock has been the target of short sellers, has endured a number of obvious short attacks, most recently in April 2004 (I sent a prior complaint about that). NFI is on the list of most heavily shorted stocks on the NYSE.

A detailed summary of trading irregularities can be found at: <http://nfi-info.net/Trading.htm>, an independent, shareholder sponsored website, including details of the current events.

The irregularities were:

1) After the close "Striping" on 12/22/2004; after the close the stock price was taken down from its close of \$56.00 to 55.71, erasing the gains of the day. Such after close takedowns have occurred frequently with NFI (again documented at above website). It seems this can only be accomplished with the complicity of the specialist. You have received numerous complaints from shareholders about this activity in the past.

2) The announcement of the Q4 dividend was covered by a number of news organizations in the most damaging light possible (GAAP declined, GAAP is known to vary widely, hedges are not counted, total earnings have been increasingly steadily; and notably a special dividend was not even mentioned!). In effect an outstanding company announcement was "spun" into a negative event. This has also happened before with NFI stock. Particular culprits this time are:

a) The Reuters and AP news releases

b) Herb Greenberg column from CBS Marketwatch. Mr. Greenberg in particular is known to have a conflict of interest dating back to his employment days at The Street.Com, and has been construing provably wrong write-ups on NFI for a considerable time. Details again at www.nfi-info.net.

3) Trading on the morning of 12/23/2004: The stock price of NFI was "taken down" by over 5\$ on very small trading volume (ca 25000 shares). This was achieved **by trading only on the Pacific Exchange**, NYSE trading of NFI did not commence until 9.47 am. By that time a volume of only several thousand shares were able to depress the share price by over 5 dollars (a short attack a few days earlier was able to depress the share price by 1.1\$ on over a million share volume). In the process this drop undoubtedly scared off a host of potential new investors, and took out a number of "stop loss" orders. The market maker and/or specialist (Fleet Boston, owned now by Bank of America) must have been complicit in this particular action. Also a number of investors charge that during this time period their buy orders lingered above the ask without getting filled, effectively shielding the ongoing PacEx trading from outside buy orders. Order details of one such market order is attached: it was entered at 9:39:58 on 12/23/2004, a time at which the Pacific Exchange was trading NFI. The order was not filled until trading commenced on the NYSE at 9:47:35. This represents proof that orders by retail clients did not make it to the market at a time when the PacEx trading was walking the NFI shareprice downwards, effectively shielded from buy orders by numerous individuals!

4) Trading on the Pacific Exchange: NFI is predominantly traded on the NYSE, on an average day about 80-90% of NFI trading occurs on the NYSE. There are however days when NFI volume is unusually high, rapid fire trading on the Pacific Exchange appears to "walk- down" the share price of NFI (many of the trades at the bid). On these days NFI trading volume happens to be 70-80% conducted at the Pacific Exchange (Again details at the shareholder website). 12/23/2004 was such a day, and many others can be pointed to. This strongly suggests manipulative trading, with the goal to lower the NFI shareprice, perhaps between related accounts. As you know the individual investor is handicapped in looking at his data, however, it would be relatively easy for you to confirm, or dismiss, the notion that this irregular trading occurs between just two or perhaps just very few accounts, buying and selling throughout those days!

I have not personally lost money yet as a result of these practices yet, even if a number of my bullish options strategies are deeply affected at this time. **However, more importantly my faith in the financial markets in the US, in the NYSE in particular, and in the financial press are irreparably damaged.** I would like to regain some confidence, which could be achieved by:

1) A formal public investigation, aggressive follow-up, and prosecution of the perpetrators of the above coordinated actions. NFI shareholders were robbed, openly and in a coordinated fashion of 100's of millions of dollars of market capitalization. The shareholders whose stop loss orders were triggered suffered significant financial loss already.

2) A related investigation into the actions related to the take-down of NFI stock in April 2004,

including the very large Put option purchases that predated that coordinated attack.
3) An investigation into the trading activities of a number of hedge funds who have shorted this stock; David Rocker of Rocker Partners comes to mind.

I am absolutely furious about this blatant manipulation of one of the most shorted stocks on the NYSE. My prior letters about this ongoing activity have garnered me a form letter in reply, however no action. You should be shamed that such an activity is allowed to occur twice with the same stock within one year.

This time a form letter from your agency will not suffice. **I demand immediate action;** starting on Monday morning to avert a repeat of what happened on 12/23/2004. I suggest close monitoring of trading activity, close supervision of the specialist, and a formal investigation into the events of 12/23/2004.

I am a European living and working in the USA. If my faith in the US financial markets is not restored I will take my assets and US investments (totaling -----), out of the United States markets, and I will advise family members and friends to do the same.

Furthermore, if no action is taken, I might be forced to conclude that your agency has no interest in protecting the small investor against powerful Wall Street players, who seem to be able to bend the system to their advantage when it is necessary.

I will spend an irrational amount of time, energy, and funds to make sure that this matter gets the attention it deserves. If this sounds like a threat, I am too frustrated to write another polite letter, and wait for my dismissal by form letter. Act now or testify later why you could not act to prevent this criminal activity to persist in your midst! I, and a number of NFI shareholders are sufficiently agitated to pursue a private or class action lawsuit against the NYSE (for failure to police itself), Fleet Boston and Bank of America for assisting in the illegal trading on the morning of 12/23/2004 and many other times, and all others involved in this action. We will also push for congressional hearings in this matter, and much tighter legislative and law enforcement oversight of the financial system.

Sincerely, and still, somehow, trusting in your ability to help,

Andreas Kaubisch (NFI shareholder)

Attachments:

- E-mail from -----, regarding his market order of the 12/23/2004 am
- E-mail from -----, regarding his GTC order that am
- Copy of Yahoo NFI message board, message # 241391, outlining her attempt to purchase stock at the open 12/23