EXECUTIVE OVERVIEW

We are a leading financial services firm that provides electronic and voice access to the capital markets across multiple asset classes for buy-side, sell-side and corporate clients. We also have provided asset management services for institutional and private clients through our Asset Management segment, which we are in the process of preparing to exit. We continually apply knowledge and innovation to the trade execution process to build lasting client partnerships through consistent performance and superior client service. We have three operating segments, Global Markets, Asset Management and Corporate.

- Global Markets – Our Global Markets segment provides market access and trade execution services in nearly every U.S. equity security and a large number of international securities, fixed income, foreign exchange, futures and options. Our approach to trading combines deep liquidity with robust trading technology and capital facilitation, when necessary, to deliver high quality trade executions consistent with client-defined measures.

- Asset Management – Our Asset Management segment consists of our 51% ownership of Deephaven Capital Management Holdings LLC ("Deephaven Holdings"), the parent company of Deephaven Capital Management LLC and its subsidiaries (collectively, "Deephaven"), a global, multi-strategy alternative investment manager. Assets under management were $2.0 billion as of December 31, 2008, down from $3.9 billion of assets under management as of December 31, 2007.

  Due to unprecedented market conditions, pending redemptions and industry-wide changes in margin and finance requirements, and after evaluation of a number of strategic options, the Company concluded that it was in the best interests of investors in the Deephaven Funds and the Company's shareholders to exit our Asset Management segment. For information regarding our plan to exit from our Asset Management segment, refer to the "Deephaven" and "Subsequent Events" sections within this Management's Discussions and Analysis of Financial Condition and Results of Operations ("MD&A").

- Corporate – Our Corporate segment includes investment income earned on strategic investments and our corporate investment as a limited partner or non-managing member in funds managed by the Asset Management segment (the "Deephaven Funds") and all corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, directors' fees, investor and public relations expenses and directors' and officers' insurance.

The following table sets forth: (i) Revenues, (ii) Expenses, (iii) Minority interest expense, (iv) Other income and (v) Pre-tax earnings (loss) after minority interest expense of our segments and on a consolidated basis (in millions):

For the years ended December 31,	2008	2007	2006
Global Markets			
Revenues	$ 998.5	$739.9	$657.6
Expenses	641.1	559.6	507.3
Pre-tax earnings	357.5	180.4	150.3
Asset Management			
Revenues	33.3	118.2	214.9
Expenses	52.6	101.7	140.1
Pre-tax (loss) earnings	(19.4)	16.5	74.8
Minority interest expense	6.2	–	–
Pre-tax (loss) earnings after minority interest expense	(25.5)	16.5	74.8
Corporate			
Revenues	1.1	27.1	66.9
Expenses	40.9	31.5	35.5
Other income	15.9	8.8	–
Pre-tax (loss) earnings	(23.8)	4.3	31.4
Consolidated			
Revenues	1,032.9	885.2	939.5
Expenses	734.6	692.7	682.9
Other income	15.9	8.8	–
Pre-tax earnings	314.3	201.2	256.5
Minority interest expense	6.2	–	–
Pre-tax earnings after minority interest expense	$ 308.1	$201.2	$256.5

Totals may not add due to rounding.

Consolidated Revenues in 2008 increased $147.7 million, or 16.7% from 2007, consolidated Expenses increased $41.8 million or 6.0% from 2007 and Other income increased $7.2 million, or 82.1% from 2007. Overall, Consolidated Pre-tax earnings after minority interest expense in 2008 increased $106.9 million, or 53.1% from 2007.

The changes in our Pre-tax earnings after minority interest expense by segment from 2007 to 2008 are summarized as follows:

- Global Markets – Our Pre-tax earnings from Global Markets increased in 2008 by $177.1 million, or 98.2%, from 2007. The increase is primarily due to higher average daily U.S. equity dollar value traded, greater trade volumes and improved trading performance and margins.

- Asset Management – Our Pre-tax results after minority interest expense from Asset Management decreased in 2008 by $42.0 million from the results in 2007. The decrease is primarily due to lower incentive allocation fees as a result of significantly lower fund returns and lower management fees as a result of a decrease in assets under management, offset in part by a decrease in profitability-based bonuses. Asset Management revenues in 2008 were also adversely impacted by the announced closing of the Event Fund, as described further under the headings "Deephaven" and "Subsequent Events" in this MD&A.

- Corporate – Our Pre-tax results from our Corporate segment in 2008 decreased by $28.2 million from 2007, primarily due to losses on our corporate investment as a limited partner or non-managing member in the Deephaven Funds offset, in part by an increase of $7.2 million in pre-tax gains in Other income from the additional partial sale of our equity interest in Direct Edge during 2008.

CERTAIN FACTORS AFFECTING RESULTS OF OPERATIONS

We may experience significant variation in our future results of operations. These fluctuations may result from numerous factors, many of which are outside of our control. These factors include, among other things, introductions of or enhancements to trade execution services by us or our competitors; the value of our securities positions and other instruments and our ability to manage the risks attendant thereto; the volume of our trade execution activities; the dollar value of securities traded; the composition of our order flow; volatility in the securities markets; our market share with institutional and broker-dealer clients; the performance and size of, and volatility in, our quantitative market-making and program trading portfolios; the performance of our high velocity algorithmic trading models; the performance of our international operations and cost associated with our international expansion; our ability to manage personnel, overhead and other expenses, including our occupancy expenses under our office leases and expenses and charges relating to legal and regulatory proceedings; the strength of our client relationships; changes in payments for order flow and clearing, execution and regulatory transaction costs; the level of assets under management and fund returns; performance of the asset management investment strategies; the addition or loss of executive management, sales, electronic and voice trading, technology and asset management professionals; legislative, legal and regulatory changes; legal and regulatory matters; geopolitical risk; the amount and timing of capital expenditures, acquisitions and divestitures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; technological changes and events; seasonality; competition; and market and economic conditions.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in our market share, growth and profitability in our Global Markets segment. If demand for our services declines due to any of the above factors, and we are unable to adjust our cost structure on a timely basis, our operating results could be materially and adversely affected. As a result of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to continue the rates of revenue growth that we have experienced in the past or that we will be able to improve our operating results.

TRENDS

Global Economic Trends

Our businesses are affected by many factors in the global financial markets and worldwide economic conditions. These factors include the growth level of gross domestic product in the U.S., Europe and Asia, and the existence of transparent, efficient and liquid equity markets and level of trading volumes.

Economic growth continued to slow during 2008, with weakness becoming more broadly based across global economies in the second half of 2008. The U.S. economy entered a recession in the beginning of 2008 which intensified as the year progressed. Much of the slowdown was attributable to weakness in credit markets brought on by contraction in the housing market and the associated increase in mortgage defaults. Liquidity and credit concerns were further exacerbated with the changing landscape of the U.S. financial services industry. Global financial markets continued to experience substantially increased levels of volatility due to concerns about the outlook for global growth, inflation, declining asset values, and credit markets continued to experience illiquidity and wider credit spreads.

Trends Affecting Our Company

We believe that our businesses are affected by the aforementioned global economic trends as well as more specific trends. Some of the specific trends that impact our operations, financial condition and results of operations are:

- Broker-dealer clients continue to focus on statistics measuring the quality of equity executions (including speed of execution and price improvement). In an effort to improve the quality of their executions as well as increase efficiencies, market-makers have increased the level of automation within their operations. Over the past several years, the greater focus on execution quality has resulted in greater competition in the marketplace, which, along with market structure changes and market conditions, has negatively impacted the revenue capture metrics of the Company and other market-making firms.

- Equity transaction volumes executed by broker-dealers have fluctuated over the past few years due to retail investor sentiment, market conditions and a variety of other factors, resulting in a shift of product mix. Equity transaction volumes may not be sustainable and are not predictable.

- There has been consolidation among market centers over the past several years, and several regional exchanges have entered into joint ventures with broker-dealers to create their own alternative trading systems (i.e., ECNs) and compete within the OTC and listed trading venues. In addition, there are many new entrants into the market, including Alternative Trading Systems (ATSs) and dark liquidity pools. Further, many broker-dealers are offering their own internal crossing networks. These factors continue to create further fragmentation in the marketplace.

- Market structure changes, competition and market conditions have triggered an industry shift toward market-makers charging explicit commissions or commission equivalents to institutional clients for executions in OTC securities. For the majority of our institutional client orders, we charge explicit fees in the form of commissions or commission equivalents. Institutional commission rates have fallen in the past few years due to competitive forces and increased electronic trading, and may continue to fall in the future.

- Market structure changes, competition and technology advancements have also led to a dramatic increase in electronic message traffic. These increases in message traffic place heavy strains on the technology resources, bandwidth and capacities of market participants.

- Due to regulatory scrutiny over the past several years relating to equity sell-side research and the continued focus by investors on execution quality and overall transaction costs, more institutional clients allocate commissions to broker-dealers based on the quality of executions. In the past, a significant portion of institutional equity commissions were allocated to broker-dealers in exchange for either research or soft dollar and commission recapture programs.

- There has been continued scrutiny of market-makers, specialists and hedge funds by the regulatory and legislative authorities. New legislation or modifications to existing regulations and rules could occur in the future and could materially impact the Company's revenues and profitability. For example, in November 2008, FINRA enacted rules regarding the OTC Bulletin Board markets which required that all non-Nasdaq securities be subject to limit order protection. Also, further amendments to Regulation SHO and related short sale rules, could make it much more difficult for market makers to sell securities short.

- There continues to be growth in electronic equity trading, as evidenced by increased volumes in direct market access platforms, algorithmic and program trading, and ECNs and dark liquidity pools. In addition, electronic trading continues to expand to other asset classes, including options, currencies and fixed income. The expansion of electronic trading may result in the growth of innovative electronic products and competition for order flow.

- The macro-economic environment and market conditions have had an adverse impact on the profitability of alternative asset management business, such as Deephaven, resulting in volatile earnings and increased investor redemptions across the industry.

INCOME STATEMENT ITEMS

The following section briefly describes the key components of, and drivers to, our significant revenues and expenses.

Revenues

Our revenues consist principally of Commissions and fees and Net trading revenue from Global Markets and Asset management fees from Asset Management.

Revenues on transactions for which we charge explicit commissions or commission equivalents, which include the majority of our institutional client orders, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity transaction volumes with institutional clients, changes in commission rates, the growth of Knight Direct, Hotspot, Knight BondPoint and Knight Libertas and the level of our soft dollar and commission recapture activity.

Trading profits and losses on principal transactions are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of U.S. equity trade and share volumes, our revenue capture, dollar value of equities traded, our ability to derive trading gains by taking proprietary positions, changes in our execution standards, development of, and enhancement to, our quantitative market-making models, performance of our high velocity algorithmic trading models that interact with street flow, volatility in the marketplace, our mix of sell- and buy-side clients, regulatory changes and evolving industry customs and practices.

Asset management fees represent fees earned by Deephaven for sponsoring and managing the Deephaven Funds as well as fees earned from separately managed accounts. These fees consist of management fees, calculated as fixed percentages of assets under management, and incentive allocation fees, generally calculated as a percentage of the funds' and managed accounts' year-to-date profits, if any. Incentive allocation fees may be negative in certain interim periods if the funds or managed accounts lose money for such period; however, such fees will not be negative on a year-to-date basis.

The Company earns interest income from our cash held at banks and cash held in trading accounts at clearing brokers. The Company's clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions. Net interest is primarily affected by interest rates, the level of cash balances held at banks and clearing brokers and our level of securities positions in which we are long compared to our securities positions in which we are short.

Investment (loss) income and other, net primarily represents income earned, net of losses, related to our corporate investment as a limited partner or non-managing member in the Deephaven Funds, our strategic investments and returns on deferred compensation investments. Such (loss) income is primarily affected by the level of our corporate investments in our Deephaven Funds and performance by the Deephaven Funds, as well as the performance and activity of our strategic investments and changes in value of certain deferred compensation investments.

Transaction-based expenses

Transaction-based expenses include variable expenses directly incurred in conjunction with generating Net trading revenue and Commissions and fees and consist of Execution and clearance fees, Soft dollar expense, and Payments for order flow and ECN rebates.

Execution and clearance fees primarily represent fees paid to clearing brokers for clearing equities transactions, transaction fees paid to Nasdaq and other exchanges and regulatory bodies, and execution fees paid to third parties, primarily for executing trades on the NYSE and other exchanges, and for executing orders through third party ECNs. Execution and clearance fees primarily fluctuate based on changes in equity trade and share volume, changes in execution strategies, rate of clearance fees charged by clearing brokers and rate of fees paid to ECNs, exchanges and certain regulatory bodies.

Soft dollar expense represents payments to third parties in connection with our commission management programs. Soft dollar expense fluctuates based on U.S. equity share volume executed on behalf our institutional clients who participate in these programs.

Payments for order flow and ECN rebates represent payments to broker-dealer clients, in the normal course of business, for directing to us their order flow in U.S. equities and rebates for providing liquidity to Direct Edge ECN, which was included as a consolidated subsidiary in the Consolidated Statements of Operations for all periods presented from the date of acquisition until September 28, 2007 (the "Deconsolidation Date"). Payments for order flow and ECN rebates fluctuate as we modify our rates and as our percentage of clients whose policy is not to accept payments for order flow varies. Payments for order flow and ECN rebates also fluctuate based on U.S. equity share volume, our profitability and the mix of market orders and limit orders.

Other direct expenses

Other direct expenses primarily consist of Employee compensation and benefits, Communications and data processing, Depreciation and amortization, Occupancy and equipment rentals, Professional fees, Business development and Interest expense.

Employee compensation and benefits expense, our largest expense, primarily consists of salaries and wages paid to all employees and profitability-based compensation, which includes compensation paid to sales personnel, incentive compensation paid to all other employees based on our profitability and changes in value of certain deferred compensation investments. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our revenues, profitability and the number of employees. Compensation for employees engaged in sales activities is determined primarily based on a percentage of their gross revenues net of certain transaction-based expenses.

Communications and data processing expense primarily consists of costs for obtaining market data, telecommunications services and systems maintenance.

Depreciation and amortization expense results from the depreciation of fixed assets, which consist of computer hardware, furniture and fixtures, and the amortization of purchased software, capitalized software development costs, acquired intangible assets and leasehold improvements. We depreciate our fixed assets and amortize our capitalized software development costs and acquired intangible assets on a straight-line basis over their expected useful lives. We amortize leasehold improvements on a straight-line basis over the lesser of the life of the improvement or the remaining term of the lease.

Occupancy and equipment rentals consist primarily of rent and utilities related to rented premises and office equipment.

Professional fees consist primarily of legal, accounting and consulting fees.

Business development consists primarily of costs related to marketing, conferences and relationship management.

Interest expense consists primarily of cost associated with our credit facilities.

Other income

Other income consists of non-operating gains from subsidiary stock issuances relating to the partial sales of our ownership of Direct Edge ECN.

Minority interest expense

Minority interest expense primarily represents the amounts distributable to the Deephaven Managers, pursuant to the Deephaven Holdings LLC agreement and includes an accrual for a one-time minimum guaranteed distribution for 2008. For a discussion regarding the Deephaven Transaction, see the heading "Deephaven" in this MD&A.

RESULTS OF OPERATIONS

The following table sets forth the consolidated statements of operations data as a percentage of total revenues:

For the years ended December 31,	**2008**	2007	2006
Revenues			
Commissions and fees	52.2%	49.2%	41.9%
Net trading revenue	43.2%	32.3%	25.9%
Asset management fees	4.5%	13.2%	22.8%
Interest, net	0.7%	2.0%	1.7%
Investment (loss) income and other, net	(0.6)%	3.2%	7.7%
Total revenues	100.0%	100.0%	100.0%
Transaction-based expenses			
Execution and clearance fees	10.4%	13.6%	11.4%
Soft dollar expense	5.9%	5.6%	5.7%
Payments for order flow and ECN rebates	4.2%	6.2%	4.5%
Total transaction-based expenses	20.5%	25.4%	21.6%
Revenues, net of transaction-based expenses	79.5%	74.6%	78.4%
Other direct expenses			
Employee compensation and benefits	35.9%	39.1%	37.5%
Communications and data processing	4.6%	4.2%	3.5%
Depreciation and amortization	2.7%	2.5%	2.2%
Occupancy and equipment rentals	2.0%	1.6%	1.4%
Professional fees	1.9%	2.2%	2.2%
Business development	1.8%	1.8%	1.5%
Interest expense	0.5%	0.0%	0.0%
Writedown of assets and lease loss accrual, net	0.1%	(0.3)%	0.9%
Other	1.2%	1.7%	1.8%
Total other direct expenses	50.6%	52.9%	51.1%
Other Income			
Non-operating gain from subsidiary stock issuance	1.5%	1.0%	0.0%
Income from continuing operations before income taxes and minority interest	30.4%	22.7%	27.3%
Income tax expense	12.6%	8.8%	10.4%
Income from continuing operations before minority interest	17.8%	14.0%	16.9%
Minority interest expense	0.6%	0.0%	0.0%
Income from continuing operations	17.2%	14.0%	16.9%
Loss from discontinued operations, net of tax	0.0%	(0.2)%	0.0%
Net income	17.2%	13.8%	16.9%

Percentages may not add due to rounding.

YEARS ENDED DECEMBER 31, 2008 AND 2007

Revenues

Global Markets

The results of our Global Markets segment for the year ended December 31, 2008 include the full year results of KEM, KCM, Knight Direct, Hotspot, Knight BondPoint and KEMIL. EdgeTrade was acquired in January 2008 and merged into Knight Direct in August 2008. Knight Libertas was acquired in July 2008. The results of EdgeTrade and Knight Libertas are consolidated from their respective acquisition dates for the year ended December 31, 2008.

The results of Direct Edge ECN were included in the results of our Global Markets segment through the Deconsolidation Date in September 2007 and are recorded under the equity method within the Corporate segment for all periods subsequent to the Deconsolidation Date.

For the years ended December 31,	2008	2007	Change	% of Change
Commissions and fees (millions)	$ 538.9	$ 436.0	$ 102.9	23.6%
Net trading revenue (millions)	446.7	286.2	160.5	56.1%
Interest, net (millions)	3.8	14.6	(10.7)	(73.8)%
Investment income and other, net (millions)	9.1	3.2	5.9	185.7%
Total Revenues from Global Markets (millions)	$ 998.5	$ 739.9	$ 258.6	35.0%
Average daily U.S. equity dollar value traded ($ billions)	19.2	12.7	6.4	50.4%
Average daily U.S. equity trades (thousands)	2,548.0	1,334.1	1,213.9	91.0%
Nasdaq and Listed equity shares traded (billions)	195.7	113.6	82.1	72.2%
OTC Bulletin Board and Pink Sheet shares traded (billions)	802.7	821.8	(19.1)	(2.3)%
Average revenue capture per U.S. equity dollar value traded (bps)	1.5	1.6	(0.1)	(5.0)%

Total revenues from the Global Markets segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, increased 35.0% to $998.5 million in 2008, from $739.9 million in 2007. Revenues in 2008 were positively impacted by higher average daily U.S. equity dollar value traded, greater trade volumes, improved results from electronic quantitative market-making efforts, performance of our high velocity algorithmic trading models that interact with street flow and the additions of EdgeTrade and Knight Libertas offset, in part, by a decrease in revenue capture per U.S. equity dollar value traded, lower share volume in OTC Bulletin Board and Pink Sheet shares and the deconsolidation of Direct Edge ECN in September 2007.

Average revenue capture per U.S. equity dollar value traded was 1.5 basis points ("bps") in 2008, down 5.0% from 1.6 bps in 2007. The primary driver for the decrease in revenue capture was a change in the mix of our order flow due to a significant increase in Nasdaq and Listed volumes from an expanded broker-dealer client base as well as a decrease in OTC Bulletin Board and Pink Sheet shares traded. Average revenue capture per U.S. equity dollar value traded is calculated as the total of net domestic trading revenues plus U.S. institutional commissions and commission equivalents (included in Commissions and fees), less certain transaction-related regulatory fees (included in Execution and clearance fees), (collectively "Core Equity Revenues") divided by the total dollar value of the related equity transactions. Core Equity Revenues were $721.6 million and $500.8 million in 2008 and 2007, respectively. Core Equity Revenues do not include revenues from KEMIL's European institutional business, Donaldson, Knight Direct, Direct Edge ECN, Hotspot, Knight BondPoint and Knight Libertas.

Asset Management

For the years ended December 31,	2008	2007	Change	% of Change
Incentive allocation fees (millions)	$ 12.4	$ 72.4	$ (60.0)	(82.8)%
Management fees (millions)	33.9	44.3	(10.4)	(23.5)%
Interest income and other, net (millions)	(13.1)	1.4	(14.5)	NM
Total Revenues from Asset Management (millions)	$ 33.3	$ 118.2	$ (84.9)	(71.8)%
Average month-end balance of assets under management (millions)	$2,993.3	$4,087.8	$(1,094.5)	(26.8)%
Annual fund return to investors*	(32.6)%	6.8%	(39.4)%	NM

* Annual fund return represents the blended annual return across all assets under management in the Deephaven Funds.
NM – Not meaningful

Total revenues from the Asset Management segment, which primarily consist of management fees and incentive allocation fees, decreased 71.8% to $33.3 million in 2008, from $118.2 million in 2007. The decrease is primarily due to substantially lower incentive allocation fees as a result of negative blended fund returns in 2008, a decrease in management fees due to lower average assets under management, and losses associated with deferred compensation investments related to certain employees which are included in Interest income and other, net in the chart above. Asset management fees were also adversely affected by the announced closing of the Event Fund during the first quarter of 2008. As of February 1, 2008, and through the period of time Deephaven is returning investors' capital, no management or incentive allocation fee is being charged to investors in the Event Fund.

The average month-end balance of assets under management decreased to $3.0 billion in 2008, from $4.1 billion in 2007. The blended annual fund return across all assets under management for 2008 was a loss of 32.6%, down from a gain of 6.8% in 2007. The returns for 2008 were affected by a difficult market environment, particularly in the second half of the year, which resulted in significant losses for the various investment strategies.

Corporate

For the years ended December 31,	2008	2007	Change	% of Change
Total Revenues from Corporate (millions)	$ 1.1	$ 27.1	$ (26.0)	(96.1)%
Total Other income from Corporate (millions)	15.9	8.8	7.2	82.1%
	$17.0	$ 35.8	$ (18.8)	(52.5)%
Average corporate investment balance in the Deephaven Funds (millions)	$68.2	$196.5	$(128.4)	(65.3)%

Total revenues from the Corporate segment, which primarily represents income from our corporate investments as a limited partner or non-managing member in the Deephaven Funds and other strategic investments, decreased 96.1% to $1.1 million, from $27.1 million in 2007. Income from our corporate investments in the Deephaven Funds decreased to a loss of $28.3 million in 2008, down from a gain of $17.8 million in 2007. This decrease was primarily due to negative investment returns during 2008.

Included in 2008 and 2007 are pre-tax gains of $51.6 million and $13.0 million, respectively, from the partial sales of the Company's investment in Direct Edge. Pursuant to SEC guidance (SAB Topic 5H), of the $51.6 million pre-tax gain in 2008, $15.9 million is reported as Non-operating gain from subsidiary stock issuance, and $35.7 million is included in Investment (loss) income and other, net on the Consolidated Statements of Operations, while $8.8 million of the $13.0 million pre-tax gain in 2007 is reported as Non-operating gain from subsidiary stock issuance, and $4.2 million is included in Investment (loss) income and other, net on the Consolidated Statements of Operations.

Transaction-based expenses

Execution and clearance fees decreased 10.7% to $107.4 million in 2008 from $120.3 million in 2007, primarily due to the deconsolidation of Direct Edge ECN in September 2007 and lower clearing rates offset, in part, by higher trade volumes. As a percentage of total revenue, Execution and clearance fees decreased to 10.4% in 2008 from 13.6% in 2007 primarily due to the deconsolidation of Direct Edge, which had higher transaction-based expenses as a percentage of revenue, and lower clearing rates offset, in part, by lower asset management fees, which have no associated transaction-based expenses. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and operational efficiencies and scale. Soft dollar expense increased 21.9% to $60.7 million in 2008, from $49.8 million in 2007, due to higher institutional volumes within our commission management programs.

Payments for order flow and ECN rebates decreased 20.0% to $43.6 million in 2008 from $54.6 million in 2007. As a percentage of total revenue, Payments for order flow and ECN rebates decreased to 4.2% in 2008 from 6.2% in 2007. These decreases were primarily due to the deconsolidation of Direct Edge and a decrease in profitability-based rebates paid to broker-dealer clients offset, in part, by lower asset management fees, which have no associated transaction-based expenses.

Other direct expenses

Employee compensation and benefits expense increased 7.0% to $370.8 million in 2008 from $346.5 million in 2007. As a percentage of total revenue, Employee compensation and benefits decreased to 35.9% in 2008 from 39.1% in 2007. The increase on a dollar basis was primarily due to increased profitability and an increase in the number of employees offset, in part, by lower profitability-based bonuses at Deephaven and losses associated with deferred compensation investments related to certain employees. The number of full time employees increased to 1,045 at December 31, 2008, from 868 at December 31, 2007, primarily due to growth in our Global Markets business as well as the acquisitions of EdgeTrade and Knight Libertas. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our revenues, profitability and the number of employees.

As more fully described under the heading "Deephaven" below, for periods after February 1, 2008, profitability-based compensation payable to certain senior Deephaven managers is no longer reported as a component of compensation expense but is instead reported as Minority interest expense on the Consolidated Statements of Operations.

All other direct expenses increased by 25.0% or $30.4 million to $152.0 million in 2008 from $121.6 million in 2007. Communications and data processing expense increased primarily due to higher market data and connectivity expenses within our Global Markets segment, as well as additional costs related to EdgeTrade and Knight Libertas. Depreciation and amortization expense increased primarily due to fixed asset purchases, capitalized software development costs and acquired intangible assets. Occupancy and equipment rentals expense increased primarily due to the costs associated with our international expansion efforts and the relocation of certain offices within our Global Markets segment. Interest expense increased due to borrowings under our credit facilities. Writedown of assets and lease loss accrual, net increased due to the trade name writedown of Direct Trading Institutional, offset by a lease loss accrual adjustment benefit.

Minority interest expense

For 2008, Minority interest expense of $6.2 million relates to the accrual for the one-time minimum guaranteed distribution to certain senior Deephaven managers pursuant to the limited liability company agreement for Deephaven Holdings.

Our effective tax rate for 2008 from continuing operations of 41% differed from the federal statutory rate of 35% primarily due to state income taxes and non-deductible charges.

YEARS ENDED DECEMBER 31, 2007 AND 2006

Revenues

Global Markets

The results of our Global Markets segment for the year ended December 31, 2007 include the full year results of KEM, KCM, Knight Direct, Hotspot, Knight BondPoint and KEMIL. The results of Direct Edge ECN are included in the results of our Global Markets segment through the Deconsolidation Date and are recorded under the equity method within the Corporate segment subsequent to the Deconsolidation Date.

The results of our Global Markets segment for the year ended December 31, 2006 include the full year results of KEM, KCM, Knight Direct, KEMIL and Direct Edge ECN. Hotspot was acquired in April 2006 and Knight BondPoint in October 2006. The results of Hotspot and Knight BondPoint are consolidated from their respective acquisition dates for the year ended December 31, 2006.

For the years ended December 31,	2007	2006	Change	% of Change
Commissions and fees (millions)	$ 436.0	$ 393.2	$ 42.7	10.9%
Net trading revenue (millions)	286.2	243.8	42.4	17.4%
Interest, net (millions)	14.6	12.2	2.4	19.3%
Investment income and other, net (millions)	3.2	8.4	(5.2)	(62.1)%
Total Revenues from Global Markets (millions)	$ 739.9	$ 657.6	$ 82.3	12.5%
Average daily U.S. equity dollar value traded ($ billions)	12.7	8.1	4.6	56.6%
Average daily U.S. equity trades (thousands)	1,334.1	902.0	432.1	47.9%
Nasdaq and Listed equity shares traded (billions)	113.6	94.3	19.3	20.4%
OTC Bulletin Board and Pink Sheet shares traded (billions)	821.8	1,063.1	(241.3)	(22.7)%
Average revenue capture per U.S. equity dollar value traded (bps)	1.6	2.1	(0.5)	(25.2)%

Total revenues from the Global Markets segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, increased 12.5% to $739.9 million in 2007, from $657.6 million in 2006. Revenues in 2007 were positively impacted by higher dollar value traded, greater trade volumes and improved results from electronic quantitative market-making efforts, offset in part by a decrease in revenue capture per U.S. equity dollar value traded and lower share volume in OTC Bulletin Board and Pink Sheet shares. Revenues were also positively impacted by the growth of Direct Edge ECN through the Deconsolidation Date as well as Hotspot and Knight BondPoint.

Average revenue capture per U.S. equity dollar value traded was 1.6 basis points ("bps") in 2007, down from 2.1 bps in 2006. The primary driver for the decrease in revenue capture was a change in the mix of our order flow due to a significant increase in volumes from a new broker-dealer client base as well as a decrease in OTC Bulletin Board and Pink Sheet shares traded. Average revenue capture per U.S. equity dollar value traded is calculated as the total of net domestic trading revenues plus U.S. institutional commissions and commission equivalents (included in Commissions and fees), less certain transaction-related regulatory fees (included in Execution and clearance fees), (collectively "Core Equity Revenues") divided by the total dollar value of the related equity transactions. Core Equity Revenues were $500.8 million and $434.6 million in 2007 and 2006, respectively. Core Equity Revenues do not include revenues from KEMIL's European institutional business, Donaldson, Knight Direct, Direct Edge ECN, Hotspot and Knight BondPoint.

Asset Management

For the years ended December 31,	2007	2006	Change	% of Change
Incentive allocation fees (millions)	$ 72.4	$ 178.4	$(105.9)	(59.4)%
Management fees (millions)	44.3	35.5	8.8	24.9%
Interest income and other, net (millions)	1.4	1.0	0.5	48.5%
Total Revenues from Asset Management (millions)	$ 118.2	$ 214.9	$ (96.6)	(45.0)%
Average month-end balance of assets under management (millions)	$4,087.8	$3,420.4	$ 667.4	19.5%
Annual fund return to investors*	6.8%	22.8%	(16.0)%	(70.3)%

* Annual fund return represents the blended annual return across all assets under management in the Deephaven Funds.

Total revenues from the Asset Management segment, which primarily consists of management fees and incentive allocation fees, decreased 45.0% to $118.2 million in 2007, from $214.9 million in 2006. The decrease is primarily due to lower incentive allocation fees as a result of decreased fund returns offset, in part, by an increase in management fees due to higher average assets under management. The average month-end balance of assets under management increased to $4.1 billion in 2007, from $3.4 billion in 2006. The blended annual fund return across all assets under management for 2007 was a gain of 6.8%, down from a gain of 22.8% in 2006. The returns for 2007 were affected by the macro-economic environment, particularly in the second half of the year, which resulted in limited profit opportunities for the various investment strategies.

Corporate

For the years ended December 31,	2007	2006	Change	% of Change
Total Revenues from Corporate (millions)	$ 27.1	$ 66.9	$(39.9)	(59.5)%
Total Other income from Corporate (millions)	8.8	–	8.8	NM
	$ 35.8	$ 66.9	$(31.1)	(46.5)%
Average corporate investment balance in the Deephaven Funds (millions)	$196.5	$230.2	$(33.6)	(14.6)%

NM – Not meaningful

Total revenues from the Corporate segment, which primarily represents income from our corporate investments as a limited partner or non-managing member in the Deephaven Funds and other strategic investments, decreased 59.5% to $27.1 million, from $66.9 million in 2006. Income from our corporate investments in the Deephaven Funds decreased to $17.8 million in 2007, down from $34.2 million in 2006. This decrease was due to lower returns on a decreased average monthly investment balance.

Included in 2007 is a pre-tax gain of $13.0 million from the partial sale of our investment in Direct Edge. Pursuant to SEC guidance (SAB Topic 5H), $8.8 million of the $13.0 million pre-tax gain in 2007, is reported as Non-operating gain from subsidiary stock issuance, and $4.2 million is included in Investment (loss) income and other, net on the Consolidated Statements of Operations. Included in Revenues in 2006 is a pre-tax gain of $30.1 million related to the sale of part of the Company's equity investment in the ISE.

Transaction-based expenses

Execution and clearance fees increased 12.5% to $120.3 million in 2007 from $106.9 million in 2006, primarily due to higher trade volumes and increased business at Direct Edge ECN offset, in part, by lower clearing rates and more efficient trading. As a percentage of total revenue, Execution and clearance fees increased to 13.6% in 2007, from 11.4% in 2006 primarily due to the decrease in revenues from Asset Management, which have no associated execution and clearance fees. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and efficiencies in processing the transactions. Soft dollar expense decreased 6.6% to $49.8 million in 2007, from $53.4 million in 2006, due to lower soft dollar volumes.

Payments for order flow and ECN rebates increased 29.3% to $54.6 million in 2007 from $42.2 million in 2006. As a percentage of total revenue, Payments for order flow and ECN rebates increased to 6.2% in 2007 from 4.5% in 2006. This expense increased primarily due to increased profitability-based rebates paid to broker-dealer clients and increased third party volumes within Direct Edge ECN.

Other direct expenses

Employee compensation and benefits expense decreased 1.7% to $346.5 million in 2007 from $352.4 million in 2006. As a percentage of total revenue, Employee compensation and benefits increased to 39.1% in 2007, from 37.5% in 2006. The decrease on a dollar basis was primarily due to lower profitability-based bonuses at Deephaven, offset by an increase in the number of employees. The number of full time employees in our continuing operations increased to 868 at December 31, 2007, from 844 at December 31, 2006, primarily related to expansion of our Asset Management and Global Markets offerings in 2007 offset, in part, by the reduction due to the deconsolidation of Direct Edge ECN in September 2007.

All other direct expenses decreased by 5.1% or $6.5 million to $121.6 million for the year ended 2007 from $128.1 million for the year ended 2006. Communications and data processing expense increased primarily due to higher market data and connectivity expenses within our Global Markets segment. Professional fees decreased primarily due to decreases in legal expenses, which fluctuate based on the activity relating to various legal and regulatory proceedings offset, in part, by higher consulting expenses. Depreciation and amortization expense increased primarily due to fixed asset purchases. Writedown of assets and lease loss accrual, net decreased due to the recording of a benefit of $2.5 million in 2007, compared to a charge of $8.5 million in 2006 primarily relating to costs associated with excess real estate capacity in Jersey City, N.J.

During 2007, we entered into two sub-lease agreements for a portion of the premises for which we had previously recorded a lease loss accrual. The lease loss accrual was adjusted based on the difference between the actual terms of the sub-leases and the assumptions previously used in the calculation of the lease loss accrual. Other expenses in 2007 decreased from 2006 primarily due to a 2006 short swing profit settlement of approximately $2.8 million relating to trading by two Deephaven funds in the shares of a company while the funds owned in aggregate more than 10% of the outstanding shares of the stock of that company.

Our effective tax rate for 2007 from continuing operations of 39% differed from the federal statutory rate of 35% primarily due to state income taxes and non-deductible charges.

DEEPHAVEN

Exercise of Option by Deephaven Managers

In connection with entering into new long-term employment agreements (the "2006 Employment Agreements") in December 2006, three senior managers of Deephaven (the "Deephaven Managers") were granted an option ("the Option") to obtain a 49% interest in Deephaven Holdings to which our interests in Deephaven would be contributed. The Option became exercisable after January 1, 2008 upon Deephaven having met certain requirements regarding minimum assets under management and employee retention. On January 10, 2008, Deephaven Managing Partners, LLC ("Deephaven Partners"), an entity owned and controlled by the Deephaven Managers, provided notice to the Company that it was exercising the Option.

On February 1, 2008, after regulatory and contractual approvals were received, the Company completed the transaction whereby the Company contributed its interest in Deephaven to Deephaven Holdings and Deephaven Partners acquired a 49% interest in Deephaven Holdings in exchange for the termination of the Deephaven Managers' 2006 Employment Agreements and associated profit sharing bonuses and an equity contribution of $1 million to Deephaven Holdings by Deephaven Partners (the "Deephaven Transaction"). The Deephaven Transaction did not affect or result in any change to Deephaven's role as investment manager to the funds it managed at that time, or to the manner in which Deephaven carried out its duties as investment manager to those funds.

As part of the Deephaven Transaction, the Company and Deephaven Partners entered into a new Limited Liability Company Agreement (the "New LLC Agreement") for Deephaven Holdings. In addition, the 2006 Employment Agreements terminated and were replaced by new long-term employment agreements between Deephaven Holdings and each of the Deephaven Managers (the "New Employment Agreements"). The New Employment Agreements did not include the profit-sharing bonuses provided under the 2006 Employment Agreements; however, the Deephaven Managers continue to be entitled to participate in certain profit pools relating to specific Deephaven funds. Following the Deephaven Transaction, pre-tax earnings are allocated between the Company and, through Deephaven Partners, the Deephaven Managers in a similar manner as under the 2006 Employment Agreements. Profit-sharing bonuses under the 2006 Employment Agreements had been reported in Employee compensation and benefits on our Consolidated Statements of Operations. As a result of the Deephaven Transaction, beginning in February 2008, profits or losses allocated to the Deephaven Managers through Deephaven Partners are instead reported as Minority interest expense on our Consolidated Statements of Operations and included as Minority interest on our Consolidated Statements of Financial Condition. Minority interest expense of $6.2 million recorded for the year ended 2008 represents the accrual for the one-time 2008 minimum distribution to the Deephaven Managers pursuant to the New LLC Agreement.

Under the New LLC Agreement, we own 51% of the shares in Deephaven Holdings, and Deephaven Partners owns 49% of the shares. We are entitled to appoint a majority of the Board of Managers of Deephaven Holdings. Certain corporate actions require approval of a "super-majority" of members of the Board of Managers, including representatives of both Deephaven Partners and us. Neither party is permitted to transfer any of its interests in Deephaven Holdings to any unaffiliated third person without the consent of the other party. Any sale of Deephaven Holdings requires either (x) the consent of the holders of 75% of the shares or (y) if the aggregate consideration is in excess of $450 million, the approval of only the Deephaven Partners (subject to a right of first refusal for the benefit of the Company). Pursuant to the New LLC Agreement, proceeds from any sale or liquidation of Deephaven or Deephaven Holdings will be allocated among the Company and Deephaven Partners based upon a formula that takes into account their capital accounts at the time of such sale or liquidation and relative profit sharing percentages over a defined period of time.

Closing of Deephaven Event Fund

On January 31, 2008, Deephaven announced that it had concluded that it was in the best interests of investors in the Deephaven Event Fund LLC and the Deephaven Event Fund Ltd. (collectively, the "Event Fund") that the Event Fund return investors' capital. As a result, redemptions in the Event Fund were suspended, and Deephaven began an orderly process to reduce trading positions to cash and return investors' capital as promptly as reasonably practicable. As of February 1, 2008, and through the period of time Deephaven is returning investors' capital, no management or incentive allocation fee will be charged to investors in the Event Fund.

Suspension of Redemptions in GMS and International Volatility Strategies Funds

On October 30, 2008, Deephaven announced the immediate suspension of redemptions and withdrawals from the GMS Fund and International Volatility Strategies Fund effective prior to the October 31, 2008 redemption date. Deephaven concluded that it was in the best interests of investors in these funds to protect them from being disadvantaged by the combination of the current extreme and unprecedented market conditions, the sudden and material industry-wide changes in margin and financing requirements being imposed by prime brokers and ISDA counterparties and the impact of pending redemption requests.

Deephaven Asset Sale

For information regarding our plan to exit from the Asset Management segment, refer to the "Subsequent Events" section of this MD&A.

DISCONTINUED OPERATIONS

Loss from discontinued operations, net of tax, was $1.4 million for 2007. See Footnote 14 "Discontinued Operations and Regulatory Charges and Related Matters," included in the Consolidated Financial Statements contained elsewhere in this Annual Report.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Financial Condition

We have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short term receivables. As of December 31, 2008, we had $2.0 billion in assets, 62.4% of which consisted of cash or assets readily convertible into cash, principally receivables from brokers and dealers and securities owned. Receivables from brokers and dealers include interest bearing cash balances held with clearing brokers, including, or net of, amounts related to securities transactions that have not yet reached their contracted settlement date, which is generally within three business days of the trade date. Securities owned principally consist of equity securities that trade in Nasdaq, on the OTC Bulletin Board and on the NYSE, NYSE Alternext and NYSE Arca markets.

Asset management fees receivable includes incentive allocation fees and management fees earned for sponsoring and managing the Deephaven Funds. Deferred compensation investments consists of investments held by us, including investments as a limited partner or non-managing member in the Deephaven Funds, for deferred compensation plans related to certain of Knight's employees and directors. Other assets primarily represent deferred tax assets, deposits and miscellaneous receivables.

Total assets increased $258.8 million, or 14.7%, from $1.8 billion at December 31, 2007 to $2.0 billion at December 31, 2008. The majority of the increase in assets relates to increases in Cash and cash equivalents, Goodwill and Securities owned, held at clearing brokers, at fair value offset, in part, by decreases in Receivable from Deephaven sponsored funds and Receivable from brokers and dealers. Cash and cash equivalents increased by $218.2 million, or 98.1%, from $222.4 million at December 31, 2007, to $440.6 million at December 31, 2008, primarily due to our results of operations, the collection of our Receivable from Deephaven sponsored funds in January 2008, our borrowing of the remaining $70.0 million under our credit facilities and from our partial sale of our investment in Direct Edge. Goodwill increased by $99.4 million, or 74.8% from $132.8 million at December 31, 2007, to $232.2 million at December 31, 2008, due to the acquisitions of EdgeTrade and Knight Libertas. Securities owned, held at clearing brokers, at fair value increased by $63.5 million, or 15.4% from $412.6 million at December 31, 2007, to $476.1 million at December 31, 2008, due to an increase in the size of the securities inventory utilized in our market-making, high velocity algorithmic trading activities and trade execution services. Our securities inventory fluctuates based on trading volumes, market conditions and our pre-determined risk limits. Receivable from brokers and dealers decreased by $41.2 million, or 10.8% from $382.5 million at December 31, 2007, to $341.4 million at December 31, 2008, due to timing relating to trade date versus settlement date differences.

Total liabilities increased $109.6 million, or 12.6%, from $870.4 million at December 31, 2007 to $980.0 million at December 31, 2008. The majority of the increase in liabilities relates to increases in Long term debt and Securities sold, not yet purchased, at fair value, offset, in part, by a decrease in Payable to brokers and dealers. Long term debt increased to $140.0 million at December 31, 2008, due to our borrowing of the remaining $70.0 million under our credit facilities during the year. Stockholders' equity increased by $142.0 million, from $885.4 million at December 31, 2007 to $1.0 billion at December 31, 2008. The increase in Stockholders' equity from December 31, 2007 was a result of our net income earned during 2008 and the issuance of common stock related to the acquisitions of EdgeTrade and Knight Libertas offset by common stock repurchases during the period.

Liquidity and Capital Resources

We have financed our business primarily through cash generated by operations, the proceeds from our stock issuances, the proceeds of the sale of our Derivative Markets segment in 2004 and the proceeds from our borrowing of $140.0 million under our credit facilities. At December 31, 2008, we had net current assets, which consist of net assets readily convertible into cash less current liabilities, of approximately $418.0 million.

We have previously disclosed our intent to pursue selective acquisitions of (or possible joint ventures with) complementary businesses primarily in the markets in which our Global Markets segment operates. We expect to fund the purchase price of any such acquisition with our current cash position or, in some cases, through the issuance of the Company's stock or debt.

We have acquired several businesses over the last few years. In January 2008, we completed the acquisition of EdgeTrade Inc. for $58.2 million comprising $28.2 million in cash and approximately 2.3 million shares of unregistered Knight common stock valued at $30.0 million. In July 2008, we completed the acquisition of Libertas Holdings LLC for an upfront payment of $75.3 million, comprising $50.3 million in cash and approximately 1.5 million shares of unregistered Knight common stock valued at $25.0 million.

Several of these past acquisitions provided for contingent payments. The acquisition of the business of Direct Trading in 2005 resulted in a final contingent cash payment of $10.4 million, paid in the third quarter of 2007, based on the profitability of that business during the second year of operation after acquisition. The terms of the Libertas Holdings LLC transaction include a potential earn-out of up to $75.0 million of unregistered Knight common stock based on the future performance of Knight Libertas during the three-year period following the closing of the transaction.

Income from continuing operations before income taxes and minority interest expense was $314.3 million, $201.2 million and $256.5 million for 2008, 2007 and 2006, respectively. Included in these amounts were certain non-cash expenses such as stock-based compensation, depreciation, amortization and certain non-cash writedowns, and in 2008 and 2007, non-cash gains from subsidiary stock issuances. Stock-based compensation was $35.0 million, $31.0 million and $20.8 million during 2008, 2007 and 2006, respectively. Depreciation expense was $7.7 million, $6.8 million, and $6.4 million in 2008, 2007 and 2006, respectively. Amortization expense, which related to software, software development costs, intangible assets and leasehold improvements, was $19.8 million, $15.3 million and $14.2 million during 2008, 2007 and 2006, respectively. Non-cash gains were $15.9 million and $8.8 million during 2008 and 2007, respectively, representing non-operating gains from subsidiary stock issuances. Non-cash writedown of $2.5 million in 2008 represents the writedown of the Direct Trading Institutional trade name.

Capital expenditures were $38.3 million, $15.1 million and $13.0 million during 2008, 2007 and 2006, respectively. Purchases of strategic investments were $13.4 million, $10.4 million and $38.8 million and proceeds from sale of strategic investments were $48.8 million, $5.5 million and $33.1 million during 2008, 2007 and 2006, respectively. During 2008 and 2007, we received proceeds of $47.5 million and $12.9 million, respectively, relating to the sales of our investment in ISE Stock Exchange and a portion of our interest in Direct Edge. Payments relating to acquisitions of businesses were $77.3 million, $10.4 million and $111.3 million during 2008, 2007 and 2006, respectively. Strategic investments and acquisition expenditures primarily relate to outside investments and acquisitions of businesses in support of the development and growth of our business. Our corporate investment as a limited partner or non-managing member in the Deephaven Funds decreased by $36.6 million in 2008, due to a loss on our investment of $28.3 million and redemptions of $8.4 million and decreased by $103.8 million in 2007, primarily due to redemptions of $120.0 million.

In October 2007, we entered into a three-year $140.0 million credit agreement ("Credit Agreement") with a consortium of banks. The Credit Agreement includes a three-year delayed-draw senior secured term loan facility of $70.0 million and a three-year senior secured revolving facility of $70.0 million. As of December 31, 2008, we borrowed the full $140.0 million under the Credit Agreement. The proceeds of the borrowings under the Credit Agreement were used to finance share repurchases, finance selective acquisitions and for general corporate purposes. These credit obligations may limit our ability to undertake certain transactions, including, but not limited to, certain mergers, acquisitions or dispositions of assets, repurchases of shares and payment of dividends, each above certain thresholds as set forth in the Credit Agreement. The borrowings under the Credit Agreement are repayable in full by October 3, 2010. Our ability to repay or refinance borrowings under the Credit Agreement will depend on our financial and operating performance and the credit environment at the maturity date.

The Credit Agreement includes customary representations, warranties, affirmative and negative covenants (including, among others, limitations on certain payments, investments and transactions) and events of default. It also contains financial covenants tied to the maintenance of financial ratios and metrics. As of December 31, 2008, we were in compliance with all covenants of the Credit Agreement.

The Company has an authorized stock repurchase program of $1 billion. We repurchased 7.9 million shares for $124.2 million and 17.5 million shares for $259.2 million under the stock repurchase program during 2008 and 2007, respectively. Through December 31, 2008, we had repurchased 67.1 million shares for $750.4 million under our stock repurchase program. We may repurchase shares from time to time in open market transactions, accelerated stock buyback programs, tender offers, privately negotiated transactions or by other means. Repurchases may also be made under Rule 10b5-1 plans. The timing and amount of repurchase transactions will be determined by our management based on its evaluation of market conditions, share price, legal requirements and other factors. The program may be suspended, modified or discontinued at any time without prior notice. We caution that there are no assurances that any further repurchases will actually occur. We had approximately 90.1 million shares of Class A Common Stock outstanding as of December 31, 2008.

Our U.S. registered broker-dealers are subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and require the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1. These regulations also prohibit a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to its parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 120% of its required minimum capital. Moreover, broker-dealers are required to notify the SEC and FINRA prior to repaying subordinated borrowings, paying dividends and making loans to its parent, affiliates or employees, or otherwise entering into transactions, which, if executed, would result in a reduction of 30% or more of its excess net capital (net capital less minimum requirement). The SEC has the ability to prohibit or restrict such transactions if the result is detrimental to the financial integrity of the broker-dealer. As of December 31, 2008, all of our broker-dealers were in compliance with the applicable regulatory net capital rules. The following table sets forth the net capital levels and requirements for the following significant regulated broker-dealer subsidiaries at December 31, 2008, as reported in their respective regulatory filings (in millions):

Entity	Net Capital	Net Capital Requirement	Excess Net Capital
KEM	$125.5	$9.5	$115.9
KCM	157.2	1.2	155.9
Knight Direct	20.6	0.9	19.6
Knight Libertas	7.9	0.7	7.2

In addition, our foreign registered broker-dealers are subject to certain financial resource requirements of the FSA and SFC. The following table sets forth the financial resource requirement for the following significant foreign regulated broker-dealer at December 31, 2008 (in millions):

Entity	Financial Resources	Resource Requirement	Excess Financial Resources
KEMIL	$34.7	$13.7	$21.0

CONTRACTUAL OBLIGATIONS

In connection with its operating activities, the Company enters into certain contractual obligations. The Company's future cash payments associated with its contractual obligations pursuant to its operating leases, net of sublease obligations and guaranteed employment contracts longer than one year as of December 31, 2008 are summarized below (in millions):

Payments due in:	2009	2010–2011	2012–2013	Thereafter through October 31, 2021	Total
Operating lease obligations [1]	$15.8	$32.5	$31.0	$97.9	$177.2
Other obligations [1]	6.3	3.6	0.8	–	10.6
Total	$22.1	$36.1	$31.8	$97.9	$187.8

[1] See Footnote 20, "Commitments and Contingent Liabilities" to the Consolidated Financial Statements

* Totals may not add due to rounding.

Off-Balance Sheet Arrangements

As of December 31, 2008, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Effects of Inflation

Because the majority of the Company's assets are liquid in nature, they are not significantly affected by inflation. However, the rate of inflation may affect the Company's expenses, such as employee compensation, office leasing costs and communications expenses, which may not be readily recoverable in the prices of the services offered by the Company. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect the Company's financial position and results of operations.

Discontinued Operations

As of the close of business on December 9, 2004, the Company sold substantially all of the assets and certain of the liabilities that comprised the Derivatives Markets business operated by Knight Financial Products LLC and Knight Execution Partners LLC to Citigroup. The decision to sell the Derivative Markets segment was based on a review of the overall options industry, the capital and risk required to maintain this business successfully and the business' role in the Company's long-term strategy. In 2007, we recorded a charge of $1.4 million, net of tax, related to a regulatory matter involving the Derivative Markets segment.

Subsequent Events

Deephaven Asset Sale

As disclosed in a Form 8-K furnished by the Company on January 27, 2009, Deephaven announced that it entered into an Asset Purchase Agreement ("Purchase Agreement") along with Stark & Roth, Inc. (together with its affiliates, "Stark"), Deephaven Managing Partners LLC, the Company and each of the three senior managers of Deephaven, pursuant to which Deephaven has agreed to sell substantially all of its assets to Stark, and Stark will assume certain limited liabilities of Deephaven.

As consideration for the sale, Deephaven could receive: (i) a payment of up to $7.3 million on the closing date of the transaction, (ii) deferred payments of up to an additional $20.7 million to be paid between the closing date and 2011, and (iii) an additional payment in 2011 of up to $16.7 million based upon the investment return of certain assets being managed by Stark over the two year period following the closing of the transaction. Each of these payments (collectively the "Purchase Price") is subject to *pro rata* reduction to the extent that investors in the Deephaven Global Multi-Strategy Fund ("GMS Fund") representing less than $1.4 billion in assets elect to have Stark continue to manage their investment on an on-going basis.

It is currently expected that this formula-based reduction to the three components of the Purchase Price may be significant. In addition, the Purchase Price is subject to certain offsets. The closing of the transaction is subject to customary conditions, including approval of the GMS Fund investors as further described in the January 27, 2009 Form 8-K.

As disclosed in a Form 8-K filed by the Company on February 26, 2009, on February 20, 2009, Deephaven committed to begin the process of a wind-down of their business in contemplation of the Stark transaction. On this date, Deephaven began reducing their workforce by 20 employees, representing approximately 15% of their total workforce. Additional workforce reductions are expected during the first half of 2009.

In connection with the Company's exit of the Asset Management business, the Company expects that it will incur the following pre-tax charges within the Asset Management segment relating to the wind-down:

- Employee severance, deferred benefits, and retention and other employee benefit costs between $22 and $26 million;
- Lease and contract termination costs between $6 and $9 million;
- Asset write-down costs between $4 and $5 million; and
- Professional fees and other associated costs between $3 and $5 million.

Although the Company believes that these estimates are appropriate and reasonable based on available information, actual results could differ from these estimates, including whether the final outcome of the proposed transaction differs from what is currently contemplated by the Purchase Agreement. We currently anticipate that approximately 75% of the above estimated $35 to $45 million in pre-tax charges will result in future cash expenditures, which the Company believes will all be incurred in 2009. These cost estimates exclude the operational results of Deephaven prior to the completion of the transaction contemplated by the Purchase Agreement.

For further discussion on risks related to the Deephaven Asset Sale, refer to "Risk Factors" in Part I, Item 1A in our 2008 Form 10-K.

Critical Accounting Estimates

Our Consolidated Financial Statements are based on the application of GAAP which requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates and any such differences may be material to our Consolidated Financial Statements. We believe that the estimates set forth below may involve a higher degree of judgment and complexity in their application than our other accounting estimates and represent the critical accounting estimates used in the preparation of our consolidated financial statements. We believe our judgments related to these accounting estimates are appropriate. However, if different assumptions or conditions were to prevail, the results could be materially different from the amounts recorded.

Impairment of Goodwill and Intangible Assets – The useful lives of intangible assets are determined upon acquisition. Intangible assets are amortized over their respective lives. Goodwill and the useful lives of intangible assets are tested for impairment, at a minimum, annually or when an event occurs or circumstances change that signifies the existence of impairment.

Goodwill of $232.2 million as of December 31, 2008 is all related to our Global Markets segment. Goodwill is primarily related to the purchases of our listed equities market-maker, KCM, and the businesses now operating as Donaldson, Knight Direct, Hotspot, Knight BondPoint and Knight Libertas. We performed our annual test for impairment of goodwill in the second quarter of 2008 and determined that goodwill was not impaired at that time. As part of our test for impairment, we considered the profitability of the applicable reporting unit, an assessment of fair value of the reporting unit based on various valuation methodologies, as well as the overall market value of the Company, compared to the Company's book value. We believe there was no impairment of the goodwill balance at December 31, 2008.

Intangible assets, less accumulated amortization, of $90.5 million as of December 31, 2008 are all attributable to our Global Markets segment. Substantially all intangible assets resulted from the purchases of the businesses now operating as Donaldson, Knight Direct, Hotspot, Knight BondPoint and Knight Libertas. These assets, which primarily consist of customer relationships, are being amortized on a straight-line basis over their useful lives, the majority of which have been determined to range from four to 24 years. We performed our annual test for impairment of intangible assets with indefinite lives in the second quarter of 2008 and determined that intangible assets were not impaired at that time. Amortizable intangibles are tested for recoverability whenever events indicate that the carrying amounts may not be recoverable. During 2008, we discontinued the use of the Direct Trading Institutional trade name and wrote off the remaining book value of $2.5 million, and during 2007, we discontinued the use of the ValuBond Securities, Inc, trade name and wrote off the remaining book value of $110,000. No other events occurred in 2008 or 2007 that would indicate that the carrying amounts of the Company's amortizable intangibles may not be recoverable.

Financial Instruments and Fair Value – In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157 *Fair Value Measurements* ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Under SFAS 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of us. Unobservable inputs are inputs that reflect our beliefs about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

- Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

- Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Changes in fair value are recognized in earnings each period for financial instruments that are carried at fair value.

Our securities owned and securities sold, not yet purchased will generally be classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices or broker or dealer quotations with reasonable levels of price transparency.

The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy. As of December 31, 2008, our Investment in Deephaven sponsored funds, one strategic investment, as well as Deferred compensation investments met the definition of Level 2.

Certain instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. For those instruments that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. As of December 31, 2008, we did not hold any financial instruments that met the definition of Level 3.

In February 2008, FASB Staff Position FAS 157-2 ("FSP FAS 157-2") was issued. FSP FAS 157-2 delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay was intended to allow additional time to consider the effect of various implementation issues that have arisen from the application of SFAS 157. FSP FAS 157-2 is effective for fiscal years beginning after November 15, 2008. We believe that FSP FAS 157-2 will not have a material impact on our Consolidated Financial Statements.

In October 2008, the FASB issued FASB Staff Position FAS 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active* ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS 157 to consider various inputs in determining fair value under conditions when the market for certain financial assets are not active. FSP FAS 157-3 was effective immediately upon issuance. The implementation of FSP FAS 157-3 did not affect the Company's fair value measurements of financial assets or its financial condition as of December 31, 2008, nor did it affect the results of its operations for the year ended December 31, 2008.

In February 2007, the FASB issued SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* ("SFAS 159"), which provides an option for entities to choose to measure many financial instruments and certain other items at fair value. On January 1, 2008, we elected not to take the option available under SFAS 159 for the purposes of valuing certain financial instruments at fair value.

Strategic Investments – Strategic investments include non-controlling equity ownership interests held by the Company or its non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity method, at cost or at fair value. The equity method of accounting is used for investments in limited partnerships and limited liability companies that are held by the Company or any of its non-broker-dealer subsidiaries. Investments in corporations by such non-broker-dealers are held at amortized cost. The equity method of accounting is used where the Company is considered to exert significant influence on the investee. Investments are held at adjusted

cost when the Company is not considered to exert significant influence on the investee. Investments in liquid investment funds, including deferred compensation investments in mutual funds, are accounted for at fair value pursuant to SFAS 157.

Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If we assess that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, the investment is written down to its estimated impaired value.

Asset Management Fees – Deephaven earns asset management fees for managing the Deephaven Funds. Management fees, which are received monthly, are recorded as earned and are calculated as a percentage of each Deephaven Fund's monthly net assets.

Incentive allocation fees are earned based upon the performance of the Deephaven Funds and are calculated based upon a percentage of a new high net asset value, as defined in the applicable private placement offering memorandum, for the six-month performance period ended June 30 or December 31, for some funds, and for the twelve-month performance period ended December 31 for other funds. A new high net asset value is defined as the amount by which the net asset value of an investor's account in a particular Deephaven fund exceeds the greater of either the investor's highest previous net asset value in that Deephaven fund or the net asset value at the time the investor made a purchase.

We record incentive allocation fees in accordance with Method 2 of EITF Topic D-96. Under this methodology, the Company recognizes incentive allocation fee income for each interim period based upon the amount that would be due if the investment advisory relationship with the Deephaven Funds were terminated at the end of such period.

Incentive allocation fees may increase or decrease during the year based on the performance of the Deephaven Funds. As such, the incentive allocation fees, in certain circumstances, may be negative for certain periods, but not lower than zero for any six-month performance period ended June 30 or December 31, for some funds, or the twelve-month performance period ended December 31 for other funds. Incentive allocation fees are paid upon the close of each six-month performance period, or twelve-month performance period, as the case may be, and are not subject to repayment (i.e., clawback) once such performance period has closed. If a fund which has a six-month performance period incurs losses in the performance period ended December 31, we may make the determination, at our sole discretion, to return all or a portion of incentive allocation fees collected for the prior six-month performance period ending June 30 of that year.

Lease Loss Accrual – It is our policy to identify excess real estate capacity and where applicable, accrue against such future costs. In determining the accrual, a nominal cash flow analysis is performed for lease losses initiated prior to December 31, 2002, the effective date of SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities*, and costs related to the excess capacity are accrued. For lease losses initiated after December 31, 2002, our policy is to accrue future costs related to excess capacity using a discounted cash flow analysis.

The Company incurred a charge of $8.3 million in 2006, primarily related to the lease loss accrual on a portion of our lease at 545 Washington Boulevard in Jersey City, N.J., encompassing approximately 78,000 square feet, all of which was unoccupied at the time. In 2007, we recorded a benefit of $2.6 million for the adjustment of our lease loss accrual. During 2007, we entered into two sub-lease agreements at our 545 Washington Boulevard property in Jersey City, N.J. for a portion of the premises for which we had previously recorded a lease loss accrual. The lease loss accrual was adjusted based on the difference between the actual terms of the sub-leases and the assumptions used in the calculation of the lease loss accrual.

In 2008, we recorded a net benefit of $1.3 million primarily related to our lease in Jersey City. The accrual on the remaining unoccupied space of approximately 50,000 square feet was derived from assumptions and estimates based on lease terms of an anticipated additional sub-lease agreement, which assumed a sub-lease would commence in the beginning of 2010, anticipated market prices along the Jersey City waterfront and estimated up-front costs, including broker fees and build-out allowances. We continually monitor the market rates for office space and the amount of available office space in Jersey City, N.J. to assess the reasonableness of our applicable assumptions.

Market-Making and Trading Activities – Securities owned and securities sold, not yet purchased, which primarily consist of listed and OTC equities, are carried at fair value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders) and related expenses are also recorded on a trade date basis. Our clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions.

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived from our market making activities are included as a component of Net trading revenue on the Consolidated Statements of Operations.

Other Estimates – The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. In addition to the estimates that we make in connection with accounting for the items noted above, the use of estimates is also important in determining provisions for potential losses that may arise from litigation, regulatory proceedings and tax audits.

SFAS No. 123(R), *Share-Based Payment* requires that we make certain estimates and assumptions relating to volatility and forfeiture rates when determining stock-based employee compensation expense. Volatility is estimated based on several factors including implied volatility of market-traded options on our common stock on the grant date and the historical volatility of our common stock. Forfeiture rates are estimated based on historical rates of forfeiture of employee stock awards.

A portion of our Employee compensation and benefits expense on the Consolidated Statements of Operations represents discretionary bonuses, which are accrued throughout the year and paid after the end of the year. Among many factors, discretionary bonus accruals are generally influenced by our overall performance and competitive industry compensation levels.

We estimate and accrue for potential losses that may arise out of litigation, regulatory proceedings and tax audits to the extent that such losses are probable and can be estimated in accordance with SFAS No. 5 *Accounting for Contingencies*. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability accrued with respect to litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience with and industry experience with similar cases and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. For more information on our legal and regulatory matters, see "Legal Proceedings" in Part I, Item 3 included in our 2008 Form 10-K.

RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* ("SFAS 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 was effective for the Company on January 1, 2008. The adoption of SFAS 159 did not have a material impact on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R) requires the acquiring entity in a business combination to recognize the acquisition date fair value for all identifiable assets acquired, and liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development and requires the expensing of acquisition-related and restructuring costs as incurred. SFAS 141(R) is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. We will apply the provisions of SFAS 141(R) to business combinations occurring after December 31, 2008. Adoption of SFAS 141(R) will not affect our Consolidated Financial Statements, but may have an effect on accounting for future business combinations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* ("SFAS 160"). SFAS 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008 with retrospective application. We do not expect the adoption of SFAS 160 to have a material effect on our Consolidated Financial Statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* ("SFAS 161"). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early adoption encouraged. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect our Consolidated Financial Statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP FAS 142-3"). FSP FAS 142-3 removes the requirement of SFAS No. 142, *Goodwill and Other Intangible Assets* for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 is effective for the Company on December 1, 2009. We are currently evaluating the potential impact of the adoption of FSP FAS 142-3 on our Consolidated Financial Statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in calculating earnings per share under the two-class method described in SFAS No. 128, *Earnings per Share*. Additionally, FSP EITF 03-6-1 requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share and is effective for financial statements issued for fiscal years beginning after December 15, 2008; early adoption is not permitted. We do not expect FSP EITF 03-6-1 to affect our results of operations or earnings per share.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45*; and *Clarification of the Effective Date of FASB Statement No. 161* ("FSP FAS 133-1 and FIN 45-4," respectively). FSP FAS 133-1 and FIN 45-4 requires enhanced disclosures about credit derivatives and guarantees and amends FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* to exclude credit derivative instruments accounted for at fair value under SFAS No. 133. FSP FAS 133-1 and FIN 45-4 were effective for financial statements issued for reporting periods ending after November 15, 2008. Since FSP FAS 133-1 and FIN 45-4 only require additional disclosures concerning credit derivatives and guarantees, adoption of FSP FAS 133-1 and FIN 45-4 did not have an effect on our Consolidated Financial Statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a further discussion of these and other important factors that could affect our business, see Part I, Item 1A, "Risk Factors" in our 2008 Form 10-K.

Market Risk

Our market-making and trading activities expose our capital to significant risks. These risks include, but are not limited to, absolute and relative price movements, price volatility and changes in liquidity, over which we have virtually no control.

For working capital purposes, we invest in money market funds and government securities or maintain interest-bearing balances in our trading accounts with clearing brokers, which are classified as Cash and cash equivalents and Receivable from brokers and dealers, respectively, on the Consolidated Statements of Financial Condition. These financial instruments do not have maturity dates or present a material market risk, as the balances are short-term in nature and subject to daily repricing. Our cash and cash equivalents held in foreign currencies are subject to the exposure of foreign currency fluctuations. These balances are monitored daily and are not material to the Company's overall cash position.

In Global Markets, we employ proprietary position management and trading systems that provide real-time, on-line position management and inventory control. We monitor our risks by reviewing trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by senior management and an independent risk control function on a real-time basis as are individual and aggregate dollar and inventory position totals, capital allocations, and real-time profits and losses. The management of trading positions is enhanced by our review of mark-to-market valuations and position summaries on a daily basis.

In the normal course of business, we maintain inventories of exchange-listed and OTC equity securities. The fair value of these securities at December 31, 2008 and 2007 was $469.4 million and $406.2 million, respectively, in long positions and $385.0 million and $335.3 million, respectively, in short positions. The potential change in fair value, using a hypothetical 10% decline in prices, is estimated to be a loss of $8.4 million and $7.1 million as of December 31, 2008 and 2007, respectively, due to the offset of gains in short positions with the losses in long positions.

The following table illustrates, for the period indicated, our average, highest and lowest month-end inventory at market value (based on both the aggregate and the net of the long and short positions of trading securities from our OTC and listed market-making business) (in millions).

	2008		2007		2006	
	Aggregate of Long and Short Positions	Net of Long and Short Positions	Aggregate of Long and Short Positions	Net of Long and Short Positions	Aggregate of Long and Short Positions	Net of Long and Short Positions
Average month-end	$ 899.1	$107.6	$1,014.0	$29.0	$1,157.2	$30.5
Highest month-end	1,015.3	198.8	1,498.2	70.9	1,564.4	51.4
Lowest month-end	775.4	14.2	679.2	8.6	903.9	7.8

As of December 31, 2008, we had a $47.2 million corporate investment as a limited partner or non-managing member in the Deephaven Funds, $24.9 million of which was invested in the Global Multi-Strategy Fund (formerly known as "Market Neutral Fund") (the "GMS Fund") with the remaining amount held in smaller single strategy funds. As of December 31, 2008, approximately 61% of the Deephaven Funds' assets under management were in the Deephaven GMS Fund. The investment philosophy for the GMS Fund is to seek to produce returns for its investors using various investment strategies focusing on delivering attractive risk-adjusted rates of return. The performance of the GMS Fund is intended to be substantially non-correlated with the general debt and equity markets, as well as with a number of other non-traditional investment strategies. Within the GMS Fund, Deephaven generally employs a variety of investment strategies, including volatility-driven, fundamental equity, event-driven, credit-driven and global relative value macro/fixed income strategies among others. There will be unhedged asset factor risks (i.e., equity, interest rate, foreign exchange) in the GMS Fund.

Deephaven also manages single-strategy funds that pursue investment strategies which involve substantial risks based on the fact that they are less diversified strategies and could be more vulnerable to structural economic and regulatory changes, or general market conditions. The less diversified nature of these strategies may cause their performance to be more volatile and result in the incurrence of greater losses during unprofitable periods as compared to a more diversified approach.

Separately, Deephaven's business also involves specific categories of trading and operational risk. For example, although Deephaven may attempt to hedge positions as part of its trading strategies, there is no assurance that adequate hedging opportunities will exist. Moreover, Deephaven relies to a material degree on its prime brokers to provide leverage, custody, execution and other services, but there is no assurance, especially in light of current market conditions, that the prime brokers will continue to provide the amount of leverage which they have in the past, or on the same terms, or provide any of the other services they currently provide, on a cost-effective basis. Deephaven also faces significant risk from the fact that any of its trading counterparties could fail, which would likely have the effect of greatly diminishing the value of the assets which are the subject of trades with that counterparty. Finally, if Deephaven does not appropriately structure its use of leverage, the losses the funds incur could be materially exacerbated.

Deephaven monitors its trading risks by reviewing trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by management and an independent risk control function, as are individual and aggregate dollar and inventory position totals and profits and losses by strategy. The management of trading positions is enhanced by review of mark-to-market valuations and position summaries. There can be no assurances that any of the Deephaven Funds' strategies will be successful in achieving either risk control or profit objectives.

Operational Risk

Operational risk can arise from many factors ranging from routine processing errors to potentially costly incidents arising, for example, from major systems failures. We incur operational risk across all of our business activities, including revenue generating activities as well as support functions. Legal and compliance risk is included in the scope of operational risk and is discussed below under "Legal Risk."

Primary responsibility for the management of operational risk lies with the business segments and supporting functions. The business segments maintain controls designed to manage and mitigate operational risk for existing activities. As new products and business activities are developed, operational risks are identified and controls are designed to mitigate the identified risks.

Disaster recovery plans are in place for critical facilities related to our primary operations and resources and redundancies are built into the systems as deemed appropriate. We have also established policies, procedures and technologies to protect our systems and other assets from unauthorized access.

Legal Risk

Legal risk includes the risk of non-compliance with applicable legal and regulatory requirements and standards. Legal risk also includes contractual and commercial risk such as the risk that a counterparty's performance obligations will be unenforceable. We are generally subject to extensive regulation in the different jurisdictions in which we conduct our business. We have established procedures based on legal and regulatory requirements that are designed to foster compliance with applicable statutory and regulatory requirements. We have also established procedures that are designed to require that our policies relating to conduct, ethics and business practices are followed.