

Short selling explained

Short selling is an essential tool for all investors and plays a critical role in correcting overvaluation, exposing fraud and corruption, reducing risk, and enhancing market integrity.

What is short selling?

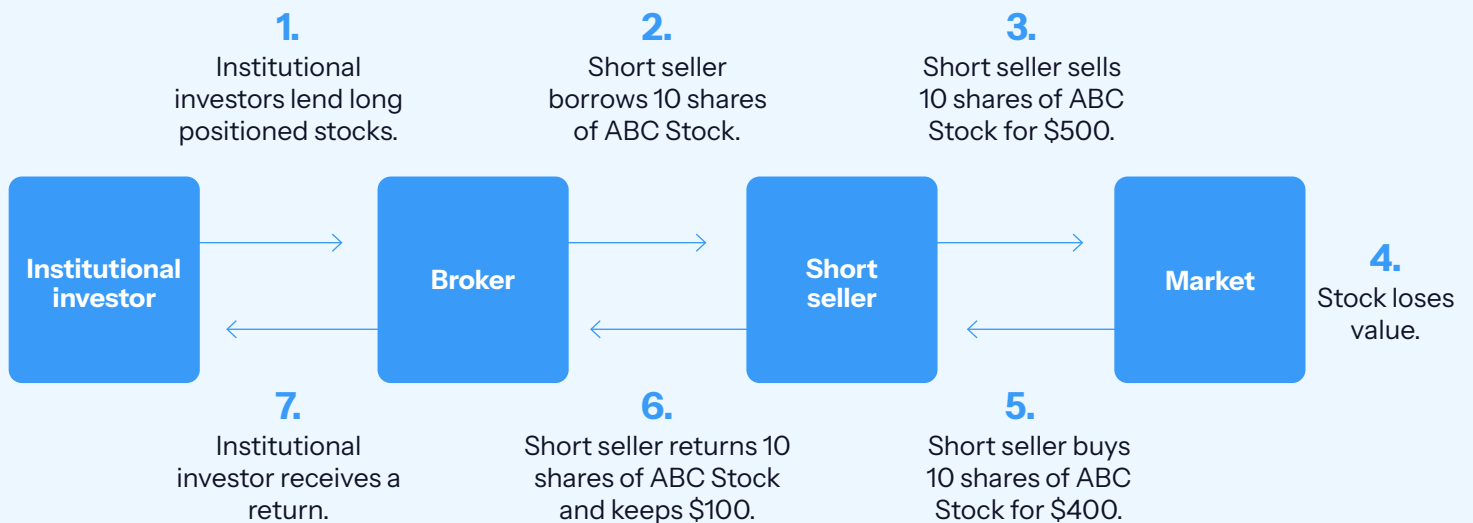
The traditional concept of stock market investing is that the market has both buyers and sellers. The buyers are often known as “longs” or “bulls,” and the sellers are often known as “shorts” or “bears.”

If an investor predicts the price of a stock will go down, they can take a “short” position. To “short a stock,” the investor borrows shares in the company from a broker in a regulated transaction, then sells the shares on the stock market. The investor then repurchases the shares later at what they anticipate will be a lower price and returns them to the broker.

If the price goes down as anticipated, the investor pockets the difference when they return the broker’s shares. But, if the share price rises, the investor will have to repurchase the shares for a higher price and incur a loss.

Pensions, mutual funds, and other institutional investors earn money lending securities to brokers and other institutional and retail investors, boosting overall returns for their portfolios and providing more funding for retirees and investors.

The broker-short investor market



The value of short selling

Having the ability to take both short and long positions allows hedge funds to **deliver risk-adjusted returns and protect their investors from volatility in the markets.**

Investors who use short selling employ sophisticated research strategies to identify mispriced assets and investment opportunities.

- In some cases, these assets can be mispriced due to fraud or illicit business practices.
- In others, investors may detect a company's management is not adapting to technological advances or emerging threats like climate change.
- And some investors simply short stock to hedge other positions. An investor could take a short position in a company without believing the fundamentals to be unsound.

Hedge funds play an essential role in getting that information into the marketplace, especially when it challenges conventional wisdom.

Short selling helps to identify market bubbles and uncover fraud:

- In 2008, short selling indicated the U.S. housing market was overvalued. Without short selling, the systemic shock of 2008 could have been far more widespread.
- Over the last 20 years short selling has uncovered a myriad of corporate frauds. These include Enron, Tyco, Worldcom, MBIA, Insys Therapeutics, Valeant, and Wirecard – just to name a few.

Managers that employ short-selling techniques take their responsibility to their investors seriously and embrace strong enforcement against market abuses. Short selling is a highly regulated activity, with robust oversight and transparency to regulators, designed to maximize market benefits including pricing, liquidity and market integrity, while protecting against abuse. Short selling is taxed at the highest level in the U.S. as short sellers do not receive capital gains treatment on their investments and pay the ordinary tax rates.