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Interviews At RealWorld Trading

Manuel Asensio: SOLD SHORT!

We are truly privileged to be joined today by short seller extraordinaire and corporate fraud buster, Manuel Asensio. In 1996, he started the internet's first private internet site devoted to investor advocacy and critical commentary on publicly traded stocks. This site's 8 year public record is the best, fully audited recommendation record ever compiled by a Wall Street firm. His mission is to hunt down and expose companies that he believes are defrauding investors. Manuel has great lessons to teach us concerning short selling, corporate fraud, and the future of the financial markets… Let's get started !

Dave: Welcome to Real World Trading, Manuel. It's a pleasure to have you here.

Manuel: Thank you for having me here.

Dave: Let's begin with a little history about yourself. Can you give me a brief background, where you are from, education, what first sparked your interest in the markets—those kind of things.

Manuel: The thing many people enjoy mentioning, both the press and the many stakeholders in our transactions, is that I am Cuban. Well, that I am. In fact, all of my family is Cuban except my wife and she's from St. Maarten in the Caribbean, so that is close. I got my undergraduate degree at Wharton and graduate degree from Harvard. I began trading stocks in my first year at Harvard in 1979. I started as a way to earn money on my savings while I was at school full time. 17 years later, in 1996, I initiated my first investor advocacy (what some call "short sell") transaction in the market for General Nutrition stock. We went on to do 26 other highly successful investor advocacy transactions, back-to-back in a row, all of them extremely well documented in the press, on the wires and live on the Internet.

Dave: Very interesting. Was there a specific event or happening that caused you to focus on short selling?

Manuel: I did not participate in the great bull market that began essentially right after I graduated Harvard Business School in 1982 up through 1996. I was an investment banker during this time, and did not invest actively in stock. Asensio & Company, Inc., the former NASD member firm I ran for 10 years, was formed in 1992. During the first 4 years we were not short selling. I saw a great opportunity to profit from mis-priced overvalued securities, which we called "grossly overvalued". We published a definition of what we called a "grossly overvalued" security in early 1997 just after we got started. I read it recently and was impressed that every one of the 27 securities in our transactions conformed to that definition. Before we started, no other investor, much less an NASD member firm, had ever questioned public companies disclosures and their stock promotions that way we did. When the profits rolled in, we merely expanded.

We put more and more money into research and developing extremely structured research methods. The result, I think, we proved that hard, smart, honest work, and adherence to principles of fundamental values, pays well, even on Wall Street.

Dave: Can you explain your definition of “grossly overvalued” securities?

Manuel: There are occasions when a stock can trade for prolonged periods of time at valuations that are far in excess of any economically justifiable level. Some of these stocks are what we called "grossly overvalued." For us to label a stock grossly overvalued, we must be unable to find any remotely possible outcome that can provide an investor with a non-risk adjusted return. In other words, even ignoring risk in assuming that the best possible outcome will occur, the stock's present price does not allow investors to realize positive return. When we believe investor's returns is undisputably negative, we label a stock grossly overvalued.

Dave: Many investors have ethical issues with the concept of short selling, thinking it's bad for the economy. How do you answer these critics?

Manuel: Americans are becoming aware of the great cost to their economy of excessive stock promotion. Look at the 2000 recession. Investors are rightfully beginning to question whose side the securities industries self-regulators are on. But I am still surprised when I speak to people about the meaning of Dick Grasso and Eliot Spitzer. After all, Eliot’s job is to chase state criminals not Wall Street bandits, he doesn’t have the specialized staff of the SEC, NYSE or NASD—so why was he able to break the mutual fund and Internet scandals and not them? Even the media has begun to understand that they can not blindly trust public companies and their stock promoters. Things changed somewhat after Enron, Winstar, Global Crossing, and WorldCom and Eliot’s successful Internet fraud prosecution. There is a lot of work to do. But I am no longer the right person to ask. People know me and my work now. However, I still run into the same old “well you are a short seller, so why would I listen to you?” when I call on local papers about some hometown stock scam. These days, I just smile and remind myself that it's part of the job.

Dave: You call your style “Activist Short Selling.” What do you mean by this?

Manuel: We talk to the press, we issue reports, we respond to company statements. And we know the subject matter to great depths. It's hard to imagine the number of analysts, brokers, bankers, members of the press, and even regulators, AMEX Richard Syron, who were stakeholders and sore losers in those 27 transactions we did from 1996 to 2003. These are the people who called the shots. They buy cheap, create the game and sell before it’s over. Our opponents were large. Before we invented the term “Activist Short Selling” these people called us “hostile and adversarial” and they insisted the short sellers had no right to promote their positions. Stock promoters like and want to protect their monopoly. They get to tell stories and short sellers have to be silent.

Activist short selling is the exact opposite. I am glad that we were successful enough to be the first short sellers to challenge the status quo.

You know I like to say that there are two things that are certain. One is that man has faults and can always do better. The second is that the status quo is always wrong.

Dave: When one shorts a stock, aren’t they theoretically taking on unlimited risk? Most of our members are active traders, how would you suggest they protect themselves from this potential unlimited risk while shorting?

Manuel: No. it is absolutely NOT true that short selling has unlimited risk. That is an excellent example of the regulatory bias towards stock promoters. You can not lose more than the value to the account. And that’s the same risk you take in buying stock. Emotionally and psychologically being short, for many, even large, experienced professional investors, is more difficult. I understand that. But the risk is no different. Do your work, know your risk. Manage your positions and your money—but above all know the value of your holdings.

Dave: Those are excellent points. Is there a simple way our members can "know the value of their holdings"?

Manuel: We calculate intrinsic value, not the market value. There is a difference between these two figures. Many people would say that this is contrary to the efficient markets theory. However, that is not accurate. It reinforces the efficient market theory. It is important that your members judge their equity holdings based on the intrinsic value and not the market value.

Dave: When evaluating a potential company to short, what specifically do you look for?

Manuel: We seek a comfortable margin of safety and a well defined end point. An outcome that we can predict with great certainty. A company and group of stock promoters who are saying the wrong things about that outcome. A stock price that shows signs that most people believe the story is also very important.

Dave: You use the term "stock promoter" often. Just to clarify, you are not just talking about the archetypical boiler room type promoter, but rather the Morgan Stanleys, Paine Webbers, and Legg Mason's of the world---is this correct ?

Manuel: I use the term stock promoter to refer to underwriters, analysts, and sell side firms. They lump all of us together as short sellers so I feel comfortable referring to all of them as stock promoters.

Dave: Do you use technical factors at all when determine what to short?

Manuel: Yes

Dave: Can you be more specific, what technical indicators do you use?

Manuel: We will sometimes select a target for research based on technical sell signals. We find Technical Analysis a good starting point. However, we WILL NOT trade or select a target based on technicals. Our best performers (shorts) have looked very strong technically. We are always driven by fundamentals.

Dave: You started your investor advocacy and short selling at the beginning of the internet bubble, most short sellers got wiped out during this period. 25 out of the 26 stocks you placed strong sells on declined dramatically. Your record is incredible--- are there still opportunities like this in the market?

Manuel: Absolutely. Our record is unique and remarkable. Our one loss is PolyMedica. It is the only one of our trades that relied on politicians and we learned that politicians don't care about protecting Medicare. PolyMedica is a shameful situation.

Of course the same biases that caused us problems also created our opportunities.

After all, regulatory barriers to short selling limited competition and regulatory support of questionable public companies, when was the last time you heard of an NASD action against a company for misrepresentation, expanded our target market.

Dave: Are you able to share one or several companies you are looking at presently to short?

Manuel: Absolutely. **Energy Conversion Devices, Inc.** [ENER|ENER] and **KFX Inc**. [KFX|KFX]. These are very questionable companies. They are using higher oil prices in their promotions.

Dave: Are you still strictly a short seller or have you balanced your approach since 2000?

Manuel: We have always been heavily invested in risk arb deals with wide spreads and distress. We manage these investments in the same way we manage our short investments—with intensive, deep fundamental research efforts.

Dave: What do you mean when you say “risk arb”? Please explain this tactic.

Manuel: We mean event-driven investing. Companies engaged in corporate events, including takeover bids, is what we mean by risk arb.

Dave: You have interesting views on the recent presidential campaign. You look at it as a phony stock promotion. Can you explain this idea?

Manuel: The similarities in tactics used to get people to buy your stock and vote for you are endless. In both, the game is sell the promise and to get people to believe you despite the facts. Many Americans believe Bush will do a better job—for them. It doesn’t matter whether he does or does not. Nor does it matter how he did it. He got elected. This race looked to me just like a battle between a short seller and a stock promoter.

Dave: Perception is more important in politics and the stock market than reality?

Manuel: Yes.

Dave: I find your views on how easily how easily the media can be manipulated by phony stock promoters fascinating. What do you attribute this to? Do you think it is desperation for a good story or what?

Manuel: It’s a function of economic interest and raw numbers. Short sellers don’t buy ads. Newspapers don’t have a problem with helping a company promote itself but always feel used, and at risk, if they take a short story. Even the best editor writing about the worse company will allow the company to tell its story no matter how bogus. They believe it’s in the interest of fairness and that the public will be able to make their own judgments. But in practice they always tilt heavily toward the public company and its many stakeholders.

The media bias against shorting will be difficult to change. There is no short selling lobby group. There is no short selling trade organization or public relations effort. The new asensio.com web site is using my past work to foster awareness and to lobby congress to eliminate the regulatory bias against short sellers. I am a realist, expansionary economic policies will always foster speculation. The Fed created money but doesn’t watch who gets the goodies. Stock promotion is a very legitimate and essential business. Without it there would be no short sellers.

Dave: You recently provided a specific example of the NY times being scammed. It was a mining company. Can you elaborate?

Manuel: I have a great deal of respect for *The New York Times*. I understand what they were trying to do. It involved the cause of a bankruptcy and the loss of employee benefits. It’s hard. It takes time and experience. The Times certainly has both. But on this one they didn’t do their homework.

Dave: I know you like the having a revolutionary public persona--Che Guevara is one of your heroes. How does Che and his revolutionaries relate to what you do in the market?

Manuel: Did you see the Motorcycle Diaries? I have had a set of experiences that few business people enjoin. I have had some very big fights and not just with the companies we’ve shorted. But with their big time investors and brokers, and with conflicted regulators, who also happened to have been my own regulators. That’s tough. And the media was no cake walk either. There were many reporters who used our information for their benefit and then sided with their big boy friends against us without blinking an eye. There are far more profitable, easier businesses. Did I choose it or did it choose me?

Dave: I will make it a point to see the Motorcycle Diaries. Thank you for the recommendation, Give us a brief synopsis of the movie plot and how it relates to what you do.

Manuel: It's a story of a young Che Guevara. Che turned down positions of power to do what he thought was right. He could of easily been a limousine revolutionary but instead suffered tremendously for what he believed was the correct and proper thing to do.

Dave: Wow, some of your investor advocacy has landed you in hot water. You expose' on Hemispherx caused you to face more than $1 billion in legal liability. That is HUGE! Perhaps one of the largest cases ever against an individual. What happened in this case?

Manuel: We won all seven of our cases. Never paid a single cent to settle any of them. Only Hemipherx, the most fraudulent of the 27, had the audacity to push the matter to trial—twice. And they lost, twice.

Dave: Do you forsee the US economy improving or declining and why?

Manuel: There is more risk in the U. S. economy than there has ever been in my career. I had never been bearish on the economy since I graduated from Harvard in 1982. The 2002 recovery was fueled by the largest, most rapidly expanding budget deficit ever created by a government. America's deficit is the largest its ever been as a percentage of GNP and in absolute dollar terms. And the trade deficit, despite the drop in the dollar, is widening. These are all important issues.

Dave: I know you are presenting a 3 step deregulation plan to Congress as an attempt to better the US equity markets. What are the 3 steps and what do you hope to accomplish with this plan?

Manuel: The securities and legal systems in the US contain numerous provisions that create liability for investment advocate positions. The opposite is true for public companies and their stock promoters. Our plan is simply to level the playing field. Regulations are rarely the answer in securities matters. By eliminating the borrowing requirement and down tick rules, which are the single most questionable and most harmful regulation. These regulations cause harmful excessive stock prices and must be eliminated. We want to provide coverage under rule 10b to investor advocates and eliminate limits on first amendment protection related to value of US securities. The US markets would be far fairer for investors and far less susceptible to industry abuses. I believe that if the US public, not just investors, were to become aware of the benefits of the Asensio 3 step plan, it would become law. However, it is difficult since the industry effectively controls both congressional committees that oversee the SEC.

Dave: Are you working on any current projects? What is your focus in 2004?

Manuel: We are always working on research, early stage right through maintenance. We are concerned about the dollar. So we are working with hard assets. This is new to us. We are working with coal, propane and heating oil distribution, lumber and energy technology.

Dave: Do you have any final words for our members?

Manuel: Always enjoy yourselves and have lots and lots of fun!!

Dave: Thank you for joining us, it has been a pleasure!