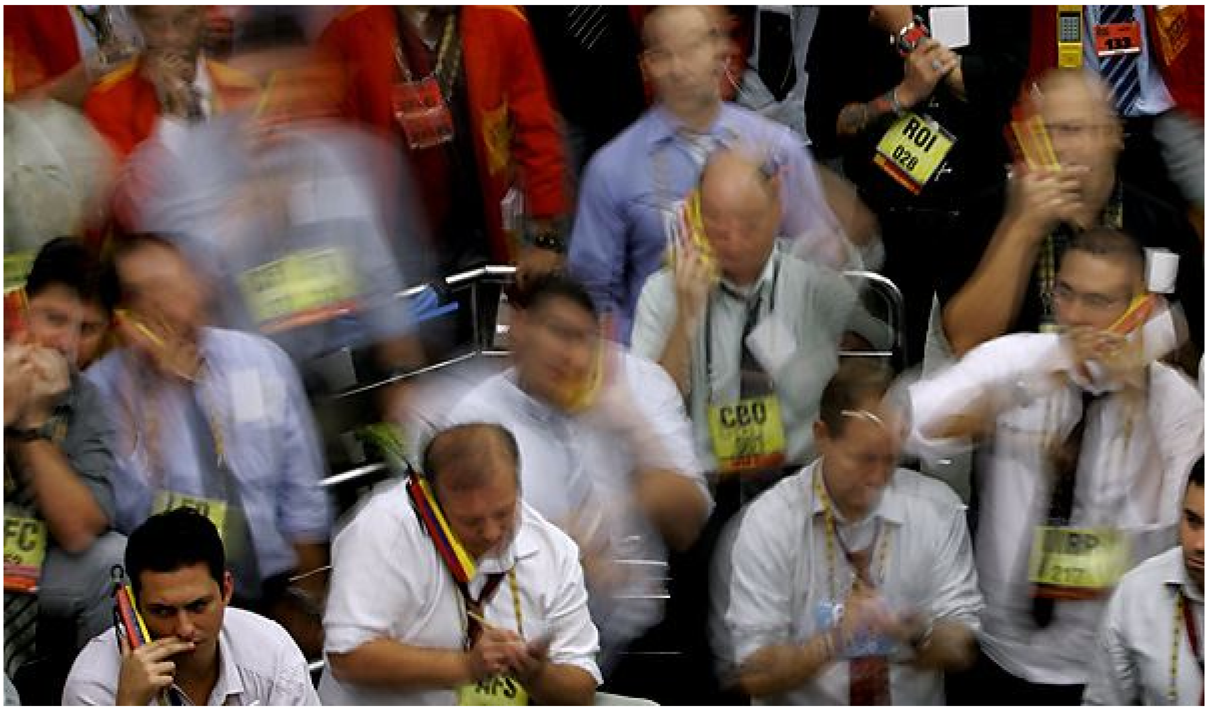
BusinessWeek

The Wizards of Short-Selling



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By Ricky McRoskey

Imagine all all-star team where all the members play short. From the Stock Market Crash of 1929 to today, some investors have had the prescience—or luck—to bet on downturns in economies, financial markets, or individual equities before they happen. They've been labeled everything from financial detectives to contrarians to saboteurs, and these investors have proven the adage that in any market, there is always someone making money. The following is a list of notable short sellers who have made—and profited from—some remarkable bearish bets:

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David Tice

President, Prudent Bear Fund

In 1999, Tice wrote a report questioning the "accounting intrigue" of $36 billion conglomerate Tyco International. Shares of the stock fell 75% in three years, and Chief Executive Officer Dennis Kozlowski was later convicted of skimming over $400 million from company funds. Years earlier, Tice had launched the short Prudent Bear Fund (BEARX) when he sensed the market was feasting on a diet of "cocaine and tequila," or propping itself up with excessive debt. It wasn't until an 18-year bull run for stocks came to an end in 2000 that his bearishness was validated.

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John Paulson

President, Paulson & Co.

The subprime mess didn't wallop everyone. In 2005, Paulson had doubts about the widespread euphoria in housing markets, so he launched funds to bet against mortgage-backed collateralized debt obligations. The funds shorted the ABX subprime index and bought undervalued "insurance default swaps"—that is, insurance against CDO default. When the housing market took a spill, Paulson's bet paid off to the tune of a $15 billion profit in 2007.

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George Soros

Chairman, Soros Fund Management

The 77-year-old Hungarian investor became "The Man Who Broke the Bank of England" in 1992, when he shorted the British pound just before Britain dropped out of the fixed exchange rate system. For years, the pound's exchange rate had been held up artificially, and Soros sold $10 billion in pounds right before the wheels came off. The result was an eye-popping $1 billion for Soros on Sept. 16, 1992.

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Jim Chanos

President, Kynikos Associates

Chanos thought something was fishy with Enron's accounting practices after he started investigating the energy trading giant in 2002. He had some practice in short selling: Back in 1982, as a 24-year-old analyst, he had predicted the collapse of a piano maker-turned-financial-company called Baldwin United. His forecast with Enron was dead-on: Within months after he shorted the stock, the Houston-based company's share price fell. Chanos watched as the price plummeted on Enron's way to bankruptcy, from $90 to less than $1 in 16 months.

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Bill Ackman

President, Pershing Square Capital Management

In 2002, Ackman wrote a 60-page research paper questioning whether bond insurer MBIA deserved the AAA rating it then boasted. The insurance giant had shifted its business model away from insuring stable municipal bonds and had begun guaranteeing CDOs backed by subprime mortgages. Ackman, principally a long-term investor, shorted the stock significantly. Although it jumped from $45 when Ackman first released the paper in 2002 to over $70 in 2006, recent events seem to have vindicated his stance: Since October, MBIA stock has fallen more than 90%.

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Jesse Livermore

Early 20th Century American Stock Trader

The Stock Market Crash of 1929 did wonders for Livermore's coffers. The Massachusetts-born investor, who had begun trading stocks at age 15, started short-selling shares feverishly before the market turned upside down in 1929. After the dust settled, Livermore had amassed over $100 million from his trades (more than $1 billion in today's dollars). Sic transit gloria: Livermore lost it all by 1934.

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Manuel Asensio

Former President, Asensio & Co.

Asensio helped define "activist investor." Originally a Cuban refugee, the fiery fund manager launched vociferous short-selling campaigns between 1996 and 2003, using press releases and public statements to drive down overvalued tech and pharmaceutical companies like Winstar and Verisign. His pre-bubble pessimism helped Asensio benefit from the dot-com crash and made it one of the country's most notorious short sellers.

Asensio's site claims that share prices of the 30 companies he shorted in those eight years declined an average of 87%.

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Alfred Winslow Jones

Former Fund Manager, A.W. Jones & Co.

The father of the hedge fund, Jones revolutionized the strategy of holding both long and short positions in a portfolio to insulate investors from market risk. The Australian-born Harvard graduate left his position as a Fortune editor in 1949 to manage $100,000 that he and several friends had invested. His strategies of short selling, using debt to enhance returns, and paying himself 20% of the fund's profits characterize many hedge funds today.

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David Einhorn

President, Greenlight Capital

The 39-year-old fund manager for the hedge fund Greenlight Capital has brought short selling into Wall Street's lap with his public criticism of Lehman Brothers (LEH), the embattled Wall Street bank that has seen two top executives resign and its shares plunge roughly 50% since Einhorn made public his short position in April. His $6 billion fund has also waged a long-standing open battle against Washington-based small-business lender Allied Capital (ALD) since 2002; Allied's share price has fallen by half since 2007.

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Philip Falcone

Senior Managing Director, Harbinger Capital Partners

Famed vulture investor Falcone, who runs the $19 billion hedge fund Harbinger Capital in New York, shorted Bear Stearns and other financial stocks before JP Morgan (JPM) and the Fed came to rescue the investment bank in March. Bear's shares sank in the turmoil, and Falcone walked away with tens of millions.