ECONOMY

Feds Issue Timeout On Short Selling

by Jim Zarroli

***All Things Considered*, September 19, 2008** · Critics say the practice called short selling has been a big reason that bank stocks have taken such a pounding, contributing mightily to the financial crisis the Bush administration is now trying to ease.

Normally, you buy a stock when you think it's going to increase in value. But what do you do when you think a stock is going to fall?

One thing you can do is sell the stock short. You borrow someone's shares, sell them, then pocket the proceeds.

Then weeks or months later, if your hunch proves right and the stock is down, you buy new shares and repay the original owner. Only now you can buy the shares for less than they first cost you, so you've made a profit.

Critics say that short sellers are opportunistic. They look for weak stocks and pile on, which hurts companies by driving down their share price.

This week, New York Attorney General Andrew Cuomo said he is investigating abuses by short sellers.

"We are watching," Cuomo said. "We are watching very closely. This is a crisis for the country's economic situation and we are not going to allow it to be exacerbated by illegal short selling."

Friday morning, the Securities and Exchange Commission said it had barred short selling of 799 insurance and financial stocks until Oct. 2.

Critics say manipulation by short sellers has hurt financial stocks like Morgan Stanley.

Doug Roberts, of channelcapitalresearch.com, says a lot of these companies desperately need capital. But if they're being targeted by short sellers and their stock price is falling, investors are afraid to go near them.

If no one invests in them, Roberts says, their price falls until they're forced into bankruptcy.

"It's kind of referred to on Wall Street as the 'death spiral,' where the company is worth more dead than alive," Roberts says.

So when the SEC announced its temporary ban this morning it had an immediate impact on stock prices.

Manuel Asensio is a longtime short seller. Hours after the ban was announced, Asensio went on his computer in his midtown Manhattan office to show me how it was affecting financial stocks.

"This is Western Alliance Bancorp," he said. "And here you see it traded as low as $13.75 this week. Today it had an opening of $27.66."

Asensio is critical of the SEC ban. He says short sellers can't really hurt stocks that have real value — not for long, anyway.

Good stocks always come back, Asensio, says. What short sellers can do is seek out stocks that have some underlying problem the public hasn't fully grasped yet.

Asensio says stocks like Morgan Stanley and Lehman Brothers fell because the companies were loaded down with bad mortgage debt that many shareholders hadn't known about.

"If these companies had been more transparent about what they owned — and if what they owned was fairly valued — we wouldn't have this problem to begin with," Asensio insists. "For government to be creating an obstacle to the price-discovery process is not good."

The SEC ban was praised by Morgan Stanley and other financial companies, who say it will address extreme and unprecedented movements in the market.

Doug Roberts is less optimistic, dismissing the SEC's move as a "temporary measure."

"I think really what they're trying to do is get some stabilization," he says. "The same way you get somebody who was in an auto accident — you try to stabilize the patient until you get to the hospital."

Roberts says the ban could work in the short run, but that eventually people who are out to manipulate the markets will find another way to do it.