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## Short Selling and the Confessions of a Wall Street Hedge Fund Manager

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Short selling of financial stocks was banned by government regulators in a knee-jerk style response to the recent financial crisis. The so called "predatory" descriptions of short selling practices evidently inflamed passions but not intellect. Failed executives used the cover of blaming short sellers for the massive price declines of their stocks, diverting focus from their own decisions. The government's reactionary banning of short selling is its public admission of the abject failure of its free market-distorting "affordable" housing policies. It is now clear to all that a government run company (Fannie Mae) could not and did not make it on its own in a free market environment.

I feel compelled to confess publicly that it is indeed true that over the past year my colleagues and I in the hedge fund world have used the free markets to short sell stocks, bonds, currencies and commodities. We have done so unashamedly and with vigor. I do not apologize for our actions. Allow me to explain why everyone should fight for this free market right.

Selling something "short" is the practice of promising to deliver a stock, commodity, or tangible good at a future time. To short sellers, profits are made from price declines and losses occur from price increases. In stocks, short transactions are initiated with borrowed shares and a promise to deliver in the future, as is so common in a mercantile society. A simple example is a farmer "sells short" his crop in the ground to the cereal maker to whom he agrees to deliver the crop at harvest time. The farmer happily accepts cash and comes out further ahead if the price declines while he forgoes any additional upside. The purchaser accepts risk of delivery but profits from the surety that the crop will be delivered for subsequent resale and any future price increases are his to keep.

A short seller of a stock sends a message to management and shareholders alike that they are headed in an adverse direction. Shareholder value will be hurt if neither management nor shareholders take positive steps to remedy inefficiencies and restore profitability. Viewed from a different perspective, would you short Warren Buffett's well-run companies? Likely not as short interest in well run companies is very low if not non-existent. Short sellers risk serious peril if they attempt to profit from the price decline of a stock of any well-run company. Here, short selling is an example of the free market providing transparency and value to all.

Secondly, short sellers are arguably a more effective regulator than the Securities and Exchange Commission (SEC). No federal agency can be

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everywhere at once. Short sellers provided taxpayers – free of charge – clear and advanced warning of the Fannie Mae debacle. Taxpayers paid the SEC staff more than one billion dollars last year. Out of all the press conferences the SEC held, not one was used to warn us of the impending debacle.

The recent government ban on this free market practice was short-sighted for a third reason. Short selling provides a significant income stream for shareholders and investors. Since most hedge funds have significant institutional and pension fund investor participation, short selling profits end up serving as a financial hedge and buffer for many retirement funds during these unprecedented periods of market volatility. In addition, shareholders earn income through the interest paid on the borrowed stock. Shareholders who are confident of the long term value of their holdings are happy to temporarily lend their shares in exchange for accepting income from traders interested in short term gains.

Finally, short selling is a free market tool that can keep poorly thought out government policies in check. Icelandic banks borrowed more than 12 times the total GDP of the country. Short sellers overcame the country's central bank defense of its currency, and the Krone lost 90 percent of its value this year. The central bank should have been directing its elected officials to be fiscally prudent instead of defending their failed policies with currency interventions in the open market. It is ultimately tragic for Icelandic citizens, but the currency declines precipitated by short sellers served up warnings well over a year ago and simply exposed a bankrupt government policy to all.

My apologies if you thought my confession here was going to be an expression of remorse. My colleagues and I will continue the free market practice of shorting of stocks, currencies and commodities as we deem appropriate for our funds and investors, I sincerely hope you will understand.

I encourage you to track how effective and responsible your government's fiscal and "regulatory" policy response is to this crisis by watching to see whether we short the U.S. dollar next.

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