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Short sellers have long—and wrongly—been blamed for market woes.

 [080923_NEWS_ticker.jpg](#) [1]

On May 9, 1901, a special train was dispatched from Chicago, a crucial cargo in its strongbox, its race to New York accompanied by the hopes of men eager to make their fortunes and the desperation of others who were seeing their savings disappear in a matter of days. More than 1,000 miles away, the *SS Oceanic*, flagship of the White Star line and one of the fastest ships on the water, had already left Liverpool, England, for New York, a similar treasure onboard.

What was this fabulous cargo? Stock certificates. The reason for the mad rush to get the certificates to New York was that shares in the Northern Pacific railroad company had gone up to \$200, \$400, and then, unbelievably, to \$1,000—in turn-of-the-century money. This was the [greatest of the stock manipulations](#) [2] that were then called "a corner" and would now be called "a short squeeze."

When the market turns down, the short sellers make for convenient scapegoats, as they have in recent days. But underneath the hue and cry about the evils of "betting against the market," the reality has been that it is not the short sellers who manipulate the market. On the contrary, it is far more often the respected names of finance and industry who are doing the manipulating by driving up the price of shares and the short sellers who are—as they were at the turn of the century—the victims.

The Northern Pacific Corner had started out as a competition between railroad tycoon Edward H. Harriman and the *éminence grise* of American finance, JP Morgan, for control of the railroad, set off by a particularly audacious effort by Harriman to buy Northern Pacific. (In the '80s, Harriman's machinations would have been called a leveraged buyout.) But Harriman and Morgan fought each other to a standstill and, between each of them and their allies, had bought up every share that was to be had in New York without either one having certain control.

The folks who didn't know this were the unfortunate short sellers. Certain (and rightly so) that there was no rational basis for the jump in Northern Pacific's stock, the shorts ordered their brokers to find shares to borrow and sell short. The brokers went to the Harriman and Morgan syndicates—and especially to JP Morgan's henchman, the stockbroker James R. Street.

The syndicates were happy to lend out the shares. At the turn of the century, short sellers had to cover their

positions and deliver the shares they'd sold in two days-not so different from the three-day rule now adopted by the Securities and Exchange Commission. The mad rush to get shares to New York happened because the stock trades had to be settled with actual paper documents. And the syndicates and people like Street knew that there were no more shares to be bought. The very same short sellers who'd borrowed shares from Street's brokerage, Street and Norton, would have no choice but to go right back to Street to get the shares to pay him back-at any price that Street cared to name.

The reason this history matters today is that the basic principle of attacking the short sellers remains surprisingly similar: Under the cover of decrying the opportunism of the shorts and their reckless ways, the very same operators who drove the market into bubble-land get to profit by stretching the game on for some more frenzied days.

Short sellers have always been the unloved stepchildren of the market. The short seller is the undertaker of the financial world, and the reigning conviction among the short-sellers' targets is that if the shorts would just stop knocking at the door, the deceased will have a chance to get his bearings and get back into action. Funny how that never seems to happen, isn't it?

In most of the recent crises, it has been short sellers, those most maligned creatures, who have been among the earliest and most vigorous in raising the alarm. James Chanos, a well-known short seller, had an [op-ed in Monday's Wall Street Journal](#) [3] justifying the short seller's art. He's earned the right to preach a little: He was the guy who shouted from the rooftops that Enron was a house of cards. And who called Lehman Bros.' fall? Another short seller, David Einhorn.

For this, the shorts have been rewarded with a passel of new rules restricting when they can short and how they need to disclose it-as well as [an outright ban](#) [4] on shorting the stocks of financial companies. (On Monday, even more companies were added to the short ban list, including Ford and General Motors.) The reasoning is that the massed attack of the shorts can pummel a company into bankruptcy, creating a run on the bank for a company that just needs some time to get its affairs in order. Well, in theory that might be possible. Yet in practice this is not what happens. What happens more often is that short sellers hold out for months as their losses mount before anybody starts listening to them.

In real life, stopping the scheming maneuvers of the short sellers may buy some companies time, but it's worth thinking about whether it's time that the targets deserve. The opportunity that is gained is not one to fix the business that's going down the tubes. By the time the short sellers are massing, the business tends to be irreparable. Corporations don't go out of business because their shares are falling; their shares plummet because they are going out of business, and restrictions on the shorts don't change that. The opportunity that's gained by slowing the advance of the shorts is that of propping up the corporate cadaver, applying some blush on the cheeks and marrying him off in a last-minute merger before anybody knows he's dead, thus palming some of the loss off on some other, more solvent company's shareholders.

Stomping on the shorts does not keep companies in business longer. Cracking down on short selling buys time for people who spent years driving their companies into the ground to grab as much of their fortunes as could be salvaged-and lets them get out while there's still some getting to be got.

(Illustration of Edison Stock Ticker by William Maver, American Telegraphy)

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