Phantom menace

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An SEC campaign backfires

NOT all short lists are worth being on. The Securities and Exchange Commission (SEC) announced rules on July 15th to restrict short-selling of 19 financial stocks. Many suspected that America's market regulator wanted to resuscitate the shares of these firms, especially those of Lehman Brothers, an investment bank, and Fannie Mae and Freddie Mac, two quasi-official mortgage agencies. The temporary regime, which expired on August 12th, banned naked short-selling—the sale of shares one has not yet borrowed. The SEC also indulged in some blood-curdling rhetoric against market "manipulation". From a simplistic perspective, its actions worked. The market value of the nine American companies on the list rose by 30%, after adjusting for capital raisings.

Yet on closer examination the picture is very different. The 19 stocks have not outperformed their peers. Nor did the SEC's action result in hordes of dishonest short-sellers scurrying to cover their positions by buying shares. Far from it. As the chart shows, for the nine American firms on the list, aggregate short positions fell only slightly: from 4.5% of shares outstanding on July 15th to 4.3% on July 31st. (For the market overall, short positions represent about 5% of shares outstanding). The net change represented an insignificant part of trading activity in these stocks over the 17-day period.

The SEC's action was not only pointless; it may have had a perverse impact. Arturo Bris, a professor at IMD Business School in Switzerland, points out that the 19 stocks had higher risk profiles than their peers, so should have bounced back more strongly than they did. He also reckons trading in the 19 stocks became less efficient. Their prices took longer to react to bad news than other firms', perhaps reflecting the red tape that short-sellers faced under the regime.

The SEC has promised a post mortem of its experiment. At this stage the conclusion looks pretty clear: the regulator picked the wrong target.