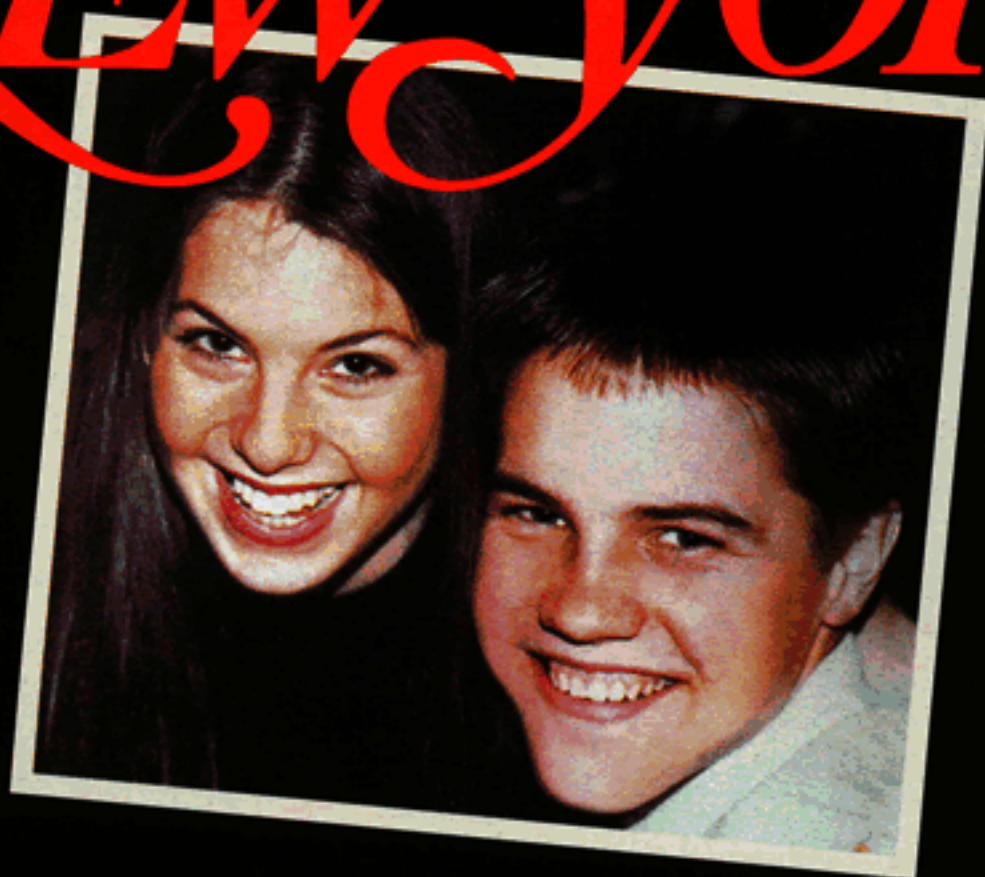


CLONING HARRY CIPRIANI • ALLERGIC TO THE CITY

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NEW YORK



THIS WEEK, WHEN SENTENCING THE HIGH SCHOOL SWEETHEARTS WHO KILLED THEIR CHILD, A JUDGE MUST DECIDE: ARE THEY MIXED-UP KIDS OR MONSTERS?

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BY MELANIE THERNSTROM

Get Shorty

In this inflated market, in which "sell" recommendations seem almost unpatriotic, short-sellers are the guys everybody loves to hate. So what if they happen to be good for the economy?

IF YOU'D LIKE TO MAKE A LARGE group of people angry very quickly, go to the craps table at any casino and put down a stack of chips on the DON'T PASS line. (This means you will be betting against the shooter.) If you bet DON'T PASS, your odds will be slightly better than if you bet with the shooter, and your bet will of course have absolutely no impact on the eventual roll of the dice. But you will nonetheless be the recipient of baleful glances and murmurs of discontent. And things won't get any better if you're proved right.

Welcome to the world of short-sellers. Short-sellers borrow shares in a company and sell them, betting that the stock's price will go down, allowing them to buy shares back at a lower price in order to return them to the lender. In a bull market, short-sellers are therefore flying in the face of what most investors believe to be true: that stocks will go up. But short-sellers are not known as "hated . . . prophets of doom," as *Business Week* put it, merely because they refuse to show team spirit. Short-selling also challenges a Wall Street status quo in which analysts feel pressure to maintain an upbeat outlook on companies and in which "sell" recommendations, in this bizarrely irrepressible bull market, are practically nonexistent. And the tens of millions of Americans who are now invested in the stock market care less about "fair value" than about making sure their investments are worth more tomorrow (a lot more) than they are today.

Contrarianism, even when intellectually justified, is not necessarily a recipe for tremendous returns, especially at a time when not even minuscule corporate-profit growth can shake investors' bullish fervor. The ranks of professional short-sellers were thinned in the early nineties and have not really filled up since. And though short-sellers successfully called the eventual stock-price collapse of some of the highest-flying stocks of the past couple of years—including companies such as Iomega, Boston Chicken, and, most recently, Sunbeam—that doesn't necessarily mean that they

reaped huge profits. At one point, for instance, Iomega short-sellers had a reported \$1 billion in paper losses, so it's not clear how many of the shorts who were there in the beginning were still around to clean up when the stock finally tumbled. "I was right, but I was early" is the short-seller's most painful lament.

SHORT-SELLERS HAVE ALWAYS BEEN despised. Napoleon believed the short-seller to be "an enemy of the State," and at different times both the British Parliament and New York State banned shorting. As Fred Schwed, the author of the Wall Street classic *Where Are the Customers' Yachts?*, put it, short-selling has traditionally been seen as "an easy way to pick up a fortune provided that you are willing to be immoral." In the wake of the 1929 crash, the short-seller became everyone's favorite villain, with one senator calling shorting "one of the greatest commercial evils of the day" and "a major cause in prolonging the Depression." And though one might expect that a bull market would make investors more sanguine about short-sellers—who, after all, can't be dragging down the market if the market just keeps rising—in fact they're still considered by many to be, as one CEO recently put it, perpetrators of "corporate slaughters."

Executives of companies whose stock prices are hurting routinely blame a short-seller "conspiracy," and legal action against short-sellers is often threatened though, tellingly, rarely taken.

In one sense, the fact that the sharpest criticism of short-selling comes from individual companies is entirely appropriate, since the work of serious short-sell-

ers is decidedly company-specific. Short-sellers play a valuable role in the market not because they're saying that the Dow Jones Industrial Average will drop by 10 percent in the next month but because they're saying that even in boom times, there are companies whose stock prices are way out of line with their true value.

Certainly the record of Manuel Asensio, perhaps the most notorious of short-sellers, testifies to that. Asensio is unusual among short-sellers—who tend to shy from publici-



ty—because he conducts all his business in the open, posting his research reports on the Internet (www.asensio.com) and issuing "strong sell" recommendations when he's decided that a company is "grossly overvalued." When Asensio shorts a stock, it's because he thinks the company is lying about either its finances or its products. Asensio may be inclined to see criminality where there's nothing more than mismanagement. But in the past three years alone, he has sure burst

the bubbles of a series of companies whose stocks were enormously pumped up, including ErgoBilt, Diana Corp., Solv-Ex, Crystallex, and BioTime. Solv-Ex, for instance, claimed that it had technology that would allow it to extract petroleum from oil-laden sand, and when Asensio issued a detailed report on why its technology was valueless, Solv-Ex's CEO accused him of "criminal activity." The company is now bankrupt. Crystallex insisted that it owned gold-mine concessions in Venezuela that it did not own. When Asensio challenged the company, it threatened to sue, issued a press release calling his attacks "baseless," and actually took out an ad in *Investors' Business Daily* that purported to refute the allegations. Just two weeks ago, the Venezuelan Supreme Court ruled that Crystallex had no rights to the mines. The stock now trades at $\frac{1}{4}$. (That's right: You can buy a share for under a buck.)

"Markets are efficient," Asensio says. "But the market can only process the information that's out there, so if companies are dishonest and if they provide information that's at odds with reality, they can create movements in their stock that would lead them to gross overvaluations. Someone's got to do the heavy pulling to expose those situations."

Asensio's single-minded focus on fraud certainly distinguishes him from the broader crop of short-sellers, as does his open combat with companies. Some fund managers, including, most notably, David Rocker of Rocker & Associates (who is short Starbucks, among others), short on fundamentals—that is, whether a company's stock price is out of line with its projected earnings growth or its return on capital. But that takes a lot of research, a lot of patience, and a lot of confidence, since overpriced stocks often move higher in the short term. Many short-sellers concentrate instead on horror-stories-in-the-making, looking for companies with egregious mismanagement and executives who are more interested in lining their own pockets than in taking care of shareholders. What's remarkable is how often they find them.


"The research of these guys is just unbelievable," says Herb Greenberg, senior columnist for *TheStreet.com*. Greenberg often relies on short-sellers as sources for his column, and he's frequently accused of being a conduit for false rumors. "It's so intense, so comprehensive," he says. "But nobody wants to hear it. I understand that. Who wants to hear that a company you own is being run horribly? But good short-sellers are obsessed with finding trouble, and if they've got you in

their sights, there's an excellent chance they'll eventually be right."

Amid all the self-congratulation we've indulged in recently over how open and transparent our financial markets are compared with the rest of the world's, it's striking to realize that fraud is still a common problem, and that using accounting gimmicks—like writing off losses as onetime charges, listing operating expenses under capital expenditures, and moving revenue from future quarters into the present one—to boost stock prices is just par for the course for many American companies. But as Greenberg suggests, and as Sunbeam's Al Dunlap discovered a couple of weeks ago, you can keep the balls in the air for only so long. Eventually, bad companies do get punished, just as good companies get rewarded. But the unworthy get punished a lot more quickly because of the kind of research that the best short-sellers do.

The irony of the attacks on short-sellers as "speculators," in fact, is that shorts often seem to be the most diligent, traditional investors of all, scrutinizing balance sheets, talking to suppliers and customers, trying, in some sense, to understand companies better than the companies understand themselves. At a time when more and more of our savings are invested in the stock market, it's easy to feel that a perpetual rise in stock prices is in everyone's interest. But the stock market isn't a machine for making investors rich. It's supposed to be a machine that ensures that capital flows to companies that use it efficiently—and away from companies, like Crystallex or Sunbeam, that use it inefficiently. And that machine needs short-sellers to work. They're the invisible hand of the invisible hand.

In brief: NOW YOU, TOO, CAN OWN A CHUNK of *The Simpsons* and *Ally McBeal*, since Rupert Murdoch's News Corporation will be spinning off its Fox television-and-movie division as a separate company. Like nearly all spin-offs, the move is intended to boost shareholder value by allowing the market to value Fox's properties independently of News Corp.'s myriad other assets. Broadcasting stocks are hot right now, so that's probably a smart move. But the spin-off will put considerable pressure on Fox's executives to deliver steady earnings growth every quarter—a difficult thing to do in the movie business, which has been squandering the investment dollars of dentists for decades. Imagine how investors would have reacted to the *Godzilla* debacle had Sony Pictures been an independent company. —

"Perfect wife" seeks suave, thin, manly type. Hollywood was my dream dear. Good looks got me signed with Warner's by age 20. Loved trading verbal shots—not to mention martinis—with William Powell. Imagine my beauty and wit in *The Mask of Fu Manchu*. And that, darling, the same year I star in *Love Me Tonight*. Few years later, Powell and I cross words in *Double Wedding*. In real life, I had four. On screen, though, I was crazy for Spencer Tracy, Clark Gable and Cary Grant, the ideal foil for my kind of humor. For some great retro repartee, catch us Thursday night, July 9, at 8pm/ET A&E's on Biography. 

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