SHORT SELLING
Professors Jaime Lester & David Horn

Preliminary Syllabus for 6 week course

Office Hours:
Professors Lester & Horn will respond to email requests within 24 hours. Should a student want to meet in person, we will try to schedule a time before class. Please contact the course assistant for all administrative issues.

Objectives & Description of the Course:

Objective: Give students a set of tools to apply short selling in today’s markets.

Description: There’s an old Wall Street adage: “Don’t short valuation.” So, is everything else fair game? What about frauds, are those sure things? The purpose of this class is to answer these questions and equip students to profitably employ short-selling investment strategies.

We will introduce students to all aspects of short-selling. However, we will assume that students have prior knowledge of the basics mechanics of shorting a stock, as well as various accounting tricks and “shenanigans” that companies employ to mask weaknesses in their business. To that end, we will provide some materials that should be reviewed before the start of class to review these concepts.

In class, we will first dig into the academic literature behind short selling. We will discuss what has worked historically, and whether or not it has been successful as of late. We will then read and discuss case studies on “famous” shorts and frauds. We will, with the benefit of hindsight, try to identify inflection points in the arc of each company. The students will also become familiar with the risks of shorting frauds too early.

We will examine various short selling strategies, including “activist shorting”, that are currently being employed in the markets. We will evaluate what elements make for a compelling short “pitch.” Additionally, students will learn about idea sourcing, portfolio management, risk management, and compliance.

While the title and focus of the class is “Short Selling,” it is important to note that the techniques and investment approaches we will discuss are highly applicable to long-focused investing as well. Deciding not to own a security that is included in a tracking index is functionally the same as shorting the security, and understanding a company’s true profitability (and not the version
that it promotes through its accounting decisions) is highly important for valuation efforts. A deep and skeptical research approach should assist fundamental analysts in all fields.

We will approach this topic from both theoretical and practical perspectives, drawing heavily on the academic literature around short selling as well as highly-experienced practitioners. We will examine what makes a profitable short, and pay particular attention to unsuccessful shorts and how to avoid them. The mosaic of analysis will include accounting, market microstructure, fundamental factors, behavioral finance, value-added research, and various valuation approaches.

**Outside Experts:** There will be a robust line-up of guest speakers, including accomplished short-sellers, academicians, and investigative journalists. We will generally have them speak for a portion of the class period in order to complement the lesson materials. These speakers will share invaluable experiences, research methods and investment anecdotes with the class.

**Final Projects:** Midway through the semester, the students will be asked to apply what they’ve learned. In groups of three, they will source (with our assistance), research, and put together a presentation on a short idea.

**Method of Evaluation**
The grade will be based on:

- 40% Final Project
- 40% Homeworks
- 20% Participation & Attendance

**Recommended Course Materials**

- There will be an introductory packet and video to be reviewed before the start of class
- Students will be given a coursepack with book excerpts and pertinent articles
- A variety of online resources will be discussed and utilized

**Class Session Description:**

**Pre-Class Assignment:**
In the introductory video and reading packet, we will discuss the basic mechanics of trading, various analytical approaches, and go over several case studies. We will touch upon the difference between active/activist short-selling and passive short-selling. Students will review accounting materials prepared in conjunction with the Earnings Quality class as well as read
select chapters of Financial Shenanigans. There will be a brief homework assignment using the Bloomberg EQS screening function.

Class 1:
Class 1 will focus on the academic literature around short-selling. We will begin by discussing the Beneish M-score homework and determining the usefulness of the framework. We will then examine several dozen academic papers and their conclusions while questioning whether the market conditions from which the data were drawn are still relevant. We will attempt to determine which conclusions remain valid, and why.

Guest speaker: Charles Jones - Columbia Professor, Short Selling Research Academic

HW: In groups, prepare a case study on a “famous” short (Enron, Valeant, VW, Wirecard, etc.) Discuss the fundamental and technical developments, and prepare an annotated stock chart that reflects this. Be prepared to discuss an optimal strategy for shorting the stock, with the benefit of hindsight.

Class 2:
Class 2 will revolve around various case studies. We will briefly discuss the cases prepared for homework and move on to several dozen other representative case studies. We will focus both on shorts that worked, and shorts that did not, or have not yet, worked. We will begin to categorize shorts and develop initial guidelines and approaches for each category.
Representative case studies include:

- Competition- consumer-facing
  - Shorts that worked: GPRO, FIT
  - Shorts that didn’t: LULU, ALGN

- Competition- business-facing
  - Shorts that worked: STEC, AVRW
  - Shorts that didn’t: ISRG, RMD

- Channel stuffing
  - Shorts that worked: FIZZ, MDXG
  - Shorts that didn’t: GMCR, UBNT, MNST

- TAM saturation
  - Shorts that worked: CWTR, VECO
  - Shorts that didn’t: NFLX, VEEV, CMG

- Frauds
  - Shorts that worked: VRX, ENE
Shorts that didn’t (yet): GSX, TSLA

Guest speaker: Mike Wilkins - Kingsford Capital

HW: Read selected activist short pitches, as assigned. Summarize the differences among the approaches of each of the activist firms, and opine on which presentations are most effective and why.

Class 3:
Class 3 will focus on activist shorting. We will examine the leading activist firms, including Hindenburg, Spruce Point, Muddy Waters, Gotham, Quintessential and others, and compare and contrast their approaches. We will use Breakout Point or Activist Insight to understand the profitability of following each of these activists.

Guest speaker: Nate Anderson (Hindenburg Research)

HW: Students will break into groups of three. Each group will be assigned 20 investment write-ups from Value Investors Club and predict which worked well and which did not. You will prepare a report that identifies common factors of a successful short as well as what makes a compelling investment memo.

Class 4:
We will go over the VIC homework assignment and discuss key drivers for short-selling. We will discuss the importance of aggressive accounting, management credibility, technical factors, valuation, competition, regulatory changes, and shareholder structure. We will begin to construct a framework for short selling that will be used for the remainder of the class. Finally, we will discuss the year-end project.

Guest speaker: Anthony Bozza - Lakewood Capital

HW: Select readings, in preparation for a discussion on a unified approach to short-selling. Students will form groups and begin the year-end project.

Class 5:
In Class 5 we will fully flesh out our framework for shorting. We will start by reviewing the material covered to date, and incorporating it into the framework. We will then expand this framework by discussing the core principles of shorting. We will develop various templates used to identify attractive short opportunities.
Guest speaker: Jim Carruthers - Sophos Capital

HW: Students will continue to work on their final projects.

Class 6:
Class 6 will start with a discussion about trading, portfolio construction, and risk management. We will discuss when to press versus when to cover, how to size positions in a portfolio framework, market structure, and macro considerations. We will also go into some depth into the process of stock lending, the fees involved in borrowing stock, and the concepts of short interest, utilization, and short squeezes.

We will then discuss value-added research and various research services. We will cover using LinkedIn for cold calling, as well as seek to understand how to best utilize expert networks. We will also discuss various datasets currently available to investors, including credit card panels, satellite imagery, search trends, and other sources.

Guest speaker: Charley Grant - WSJ

HW: Finish final project