

Staley, Kathryn F. – The Art of Short SellingJohn Wiley & Sons, 1997, [*Equity Investing*] Grade ★★☆☆

There are very few books on fundamental short selling of stocks but this is one of the more well-known ones. It covers many aspects of the trade very well but leaves others out. Unfortunately we are still waiting for the definite book on shorting, preferably written by some of the veterans of the game.

There are three parts to the book where the first gives an okay background to the area and its practitioners. Short candidates are categorized into companies that a) lie to investors through their accounting, b) have expensive valuations and c) will be negatively affected by external events. Signals used by those shorting are according to the author a) accounting warning flags, b) signs of “insider sleaze”, c) stellar stock price rises, d) cash consuming companies and e) overvalued assets or ugly balance sheets.

Then the absolute bulk of the book is a number of rather old case studies meant to exemplify different types of short selling cases – although not exactly linking to the categories in part one. The author has had good access to commentary from a number of veteran short sellers through interviews. I still think the author could have drawn more explicit deductions from these, as they now mostly resemble a line-up of successful war stories.

The storyline is that clever short sellers first see something that daft Wall-Street analysts or long-only investors couldn't detect. Then the investment case either takes longer to pan out than expected or the short sellers are tormented by violent short squeezes causing pain but in the end they are always vindicated and the company lead by the evil managers dwindles into disaster. Finally, there is a short wrap up where Staley draws some general conclusions about the field but also gives a historical account of shorting.

Kathryn Staley have, as I understand it from the sleeve of the book, worked with both hedge funds and brokerages in trying to find stocks to short. She has taught financial statement analysis for AIMR, the Association for Investment Management Research and “reads balance sheets and footnotes for fun and profit”. Despite her experience as a short seller there is very little of technical detail in the book as it is written in an anecdotal, almost journalistic, style. As an example, if Days Sales of Inventory is one of the most reliable signs of trouble as is claimed, how is the ratio calculated, what are the pros and cons of using it and which other indicators are useful to complement it with? Even though the title points to the “art” or short selling I think the “craft” could have deserved some space.

Even though the tone can sometimes become a bit too idolizing the strong aspect of the book is that you get a fair grip of the psychology of shorting and above all of the character of short sellers. Their contrarian nature is described as ambitious, cynical, driven, single minded – even pigheaded – and sometimes frugal and anti-social. They are curious, hard working and find pleasure in finding the truth and being smarter than the gullible investment crowd as stocks blow up. The author describes an almost moralist disposition since short sellers enjoy exposing the corporate fraudsters who waste the shareholders money. I also like how the book defuses short selling and shows how very similar the research into investment cases is on the short side and the long side. Long-only investors can actually learn plenty from the attention to accounting detail among short sellers.

Despite the mixed review the unfortunate truth is that there aren't many other books to recommend instead so the book could still be worth purchasing. We are still waiting for the definite reference book on shorting.

Mats Larsson, April 23, 2017