

Traders Who Sell Short Stocks Are Well-Informed

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The term “short selling” refers to the practice of selling shares the seller does not own, in the hope of repurchasing them later at a lower price. A new study in *The Journal of Finance* reveals that there is a large occurrence of shorting activity and that short sellers are highly informed about the relative value of stocks.

Led by Ekkehart Boehmer of the Mays Business School at Texas A&M University, Charles M. Jones of the Graduate School of Business at Columbia University, and Xiaoyan Zhang, of the Johnson Graduate School of Management at Cornell University, researchers used information from the New York Stock Exchange to examine the incidence and information content of short sales. Used to measure shorting flow, the sample consisted of all NYSE system order data records related to short sales from January 2000 to April 2004.

The study shows that there is a surprisingly large amount of shorting activity across both large and small NYSE stocks. During the sample period, shorting accounted for at least 12.9 % of trading volume, suggesting that shorting constraints are easily surmounted and not widespread.

The study also illustrates the extent to which short sellers are able to identify overvalued stocks and profit by anticipating price declines in these stocks. Short sellers are extremely well-informed, with institutional traders being the most informed.

The results are consistent with the emerging consensus in financial economics that short sellers possess important information, and that their trades are important contributors to more efficient stock prices.

“We think this is a promising area of research, and our high frequency data are ideal for investigating short selling immediately surrounding these kinds of corporate events,” the authors conclude.

This study is published in the April 2008 issue of *The Journal of Finance*.

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