



Think like an investor...

# The **Opposite** of **Buying**: **Shorting**

Shorting a stock allows investors to earn money when a stock's price declines. Investors short a stock at a certain price with the expectation that the price will fall. This allows them to sell the stock by borrowing it from another investor. When the stock's price drops, investors cover their short by repurchasing shares.

But be warned... ***It's a little more complicated and a lot more risky.***

# ★ Key Takeaways From This Module



## Guiding Questions

- What does it mean to short a stock?
- How do investors make money from shorting?
- What are the risks associated with shorting?

## Enduring Understandings

- Shorting can be thought of as the opposite of investing.
- Shorting occurs on margin, which means investors who short a stock use debt to do so.
- For inexperienced investors, shorting can lead to significant losses.

# ★ Key Terms About **Shorting**



**Margin:** A Ratio used to value companies which measures current share price against per share earnings

**Broker:** Returns from a company's activities after expenses have been subtracted. This may or may not include tax expense depending on the context

**Clearing Firm:** Income generated from selling goods and services. These returns are from normal business operations so it does not include windfall gains



# How Shorting Works

**Short selling consists of an investor borrowing a stock and selling that stock.** Then the investor buys the stock back and returns it to the lender. The investor is hoping that the price of the stock will decrease so that they make money from selling what they borrowed.



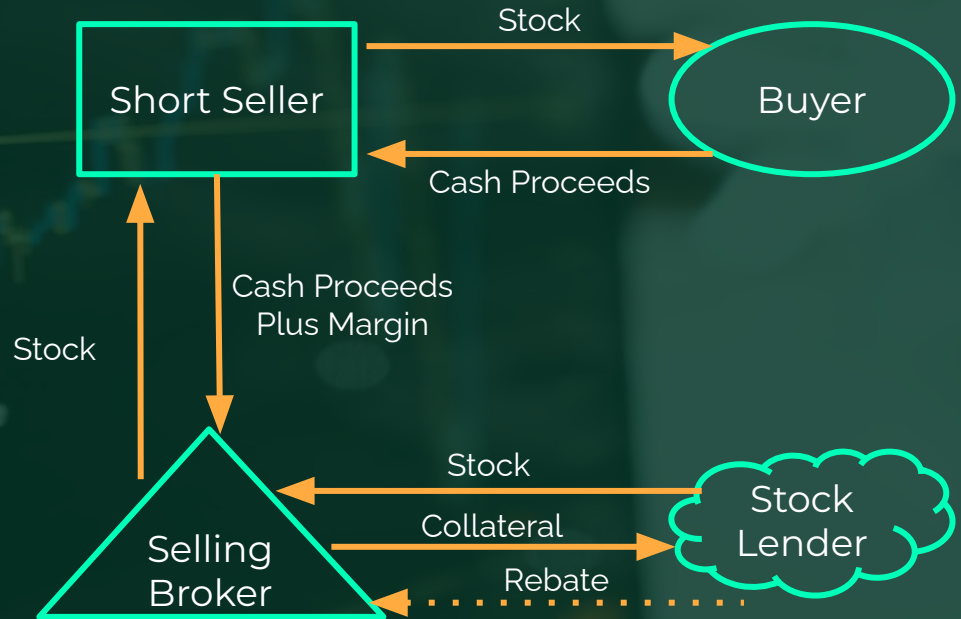


# Who Makes Money While You Short?

When shorting a stock, you have to maintain a **margin account** with the brokerage firm that you are using to short. This account provides **assurance to the brokerage firm that any losses will be covered.**

Brokerage firms also **accrue interest while shorts are out** so they make money either way the share price moves.

## Process of Short Selling



# The Perils of Shorting A Stock



## Margin Interest

You will incur **margin interest** for the period you have your shorts out. This will be deducted from some of your gains from the short so you need to **ensure that you are making more than the fees.**



## Unlimited Losses

Shorting brings **potentially unlimited losses** because if the stock skyrockets then you will be liable for a large amount of money.



## Short Squeeze

A short squeeze is where all of the shares of a company are purchased and **there are no shares for the people with shorts to buy.** This causes the price to jump drastically.

# The Big Short



**The big short is one of the biggest financial risks in history that paid off**, there's even a movie about it. It consisted of Michael Burry shorting the housing market with over \$1 billion of his investors money. He kept this short position while losing tons and tons of money because he knew that there were a lot of subprime home loans that were going to default. This would cause the bubble to bust and make him and his investors a ton of money.

However, if he hadn't been right this could have gone in a very different direction. **If the housing market had continued to rise and he had been wrong about it busting then he would have lost everything due to the unlimited loss potential.**

# Key Takeaways From This Module



## CORE & FUNDAMENTALS

- Investors who wish to short a stock borrow and sell shares, and ideally buy them back at a lower price.
- Stockbrokers lend shares to investors.
- Stocks sold on margin incur interest.

## APPLIED KNOWLEDGE

- Shorting can lead to high returns but comes with a fair amount of risk.
- It is best to short companies that show multiple signs of financial ineptitude.
- Investing is like betting on the success of a company, while shorting is betting on failure.

## RELEVANCE FOR YOU

- As you become more comfortable with normal investing, you can figure out metrics to find stocks you'd like to short
- Shorting is a great way to add higher returns to your portfolio.

