God Bless the Shorts

Ricky Musk?

Elon Musk made a lot of news last week, refusing to answer "boneheaded" questions from "boring" sell-side analysts. Adding fuel to the fire, he later took to Twitter and exclaimed "the 2 questioners I ignored on the Q1 call are sell-side analysts who represent a short-seller thesis, not investors."

He then doubled-down and stated that the "short burn of the century (is) comin soon" and that "the sheer magnitude of the short carnage will be unreal." He even added that the squeeze would "be bigger" than that which enveloped the ordinary shares of Volkswagen in 2008.

We're not ones to defend sell-side analysts. Many of them actually *are* boneheaded. But a) we aren't the CEO of a publicly-listed company, and b) we actually think that "short-selling" is a gift to capitalism.

We don't have a strong view on Tesla's shares, but when Musk refused to speak to the bearish analysts and attempted to humiliate them in a public forum, we noted that it wasn't a strategy previously employed by other visionaries like Steve Jobs or Jeff Bezos. Even folks like Reed Hastings at Netflix, for a while there under *severe* attack by the shorts, didn't condemn them, but instead engaged them with civility. In 2010, Reed even wrote a piece stating politely and lucidly why he thought the shorts were wrong, starting off describing one particularly vocal short (Whitney Tilson) as "a great investor and human being".[1] Maybe times are a changin', but at least historically, this is how the best CEOs and CFOs reacted to and engaged with short-sellers.

As an investor, we were always more drawn to management that wanted to meet with shorts in 1:1 meetings, or selectively chose to call on bearish analysts on conference calls. The CEOs that avoided them always smelled funny, and the ones that eviscerated them in public were even worse. Enron's Jeff Skilling once called Highfield's Richard Grubman an "a55hole" on a conference call. Skilling was fired four months later, and then went to jail.

We're not comparing Musk to Skilling, but we want to dispel the myth that the Tesla CEO may be trying to perpetrate. Short-sellers aren't evil, they aren't anti-American, and most of them aren't even "boneheaded" or "boring". Shorts serve a necessary function; they provide liquidity and flow, and ensure equilibrium. Firm friend Chris Malloy at HBS (and many others in the academic community) have even suggested that the shorts may even be more right than wrong.[2] So, complaining about the shorts often means you have something to hide, and banning short-selling outright is downright ludicrous.[3]

Similarly, it is very easy to overlook here that those managing long-short equity products are trying to make money for their clients. While they are indeed trying to compound their own capital (a noble pursuit itself), the bulk of hedge fund AUM are from pension funds, endowments, foundations and sovereign wealth funds; and these firms have entrusted hedge fund managers with their capital, and are counting on them to generate uncorrelated, positive returns over the long term. When the hedge fund "makes" money by shorting a stock, a university endowment can offer more scholarships, and a foundation can start another project.

If these shorts identify an opportunity where myopic short-term traders are overenthusiastic about a company's prospects (or that a company in fact is misleading the investing public, as was the case with Enron), then it is very simply their job to capture the profit from making that price efficient. This has the positive externality of simultaneously preventing the individual retail investor from overpaying for shares. That's how free trade works, and – whether buying or selling and in whichever order – an unencumbered equilibrium is a good thing.

Short-sellers have just done a bad job marketing themselves. Holistically, buying a stock for $10 and selling it after it quintuples is – on net – the same as shorting it at $50 and buying it back after it drops 80%. Instead of calling themselves short-sellers, they should re-brand as the more palatable "inverted buyers." Maybe if that were the narrative, discourse could become forthright, transparent, and civil.

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[1] *https://seekingalpha.com/article/242653-netflix-ceo-reed-hastings-responds-to-whitney-tilson-cover-your-short-position-now*
[2] *https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.2007.01269.x*
[3] *And the intermediate step of requiring additional disclosure may in fact be more destabilizing than some think short selling is in the first place, but that can be the subject of a separate discussion.*

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