chapter 1

Sages and Charlatans: Avoiding the Fads, the Buzz, the Rip-Offs, and the Merely Dumb

"You could step into the store and see what's going on. Are people buying, are there a lot of people? And then when you see the CEO and he says there are a lot of people coming into the stores, you have to compare the two. And if you know that there aren't a lot of people, then you know there is something fishy."

—Patrick Gallimore, 14, who attends a stock market education program at the Dr. Gladstone H. Atwell Middle School 61 in Brooklyn, New York

Soon after I moved to New York, in 1999, I met a Chinese woman who had saved every cent to come and study in the United States. Hers was typical of the resourceful immigrant stories on which this city lives and breathes. But it soon became a cautionary tale from which I will show how investors can learn important lessons about the nature of risk.

Altogether, my friend had managed to scrimp together more than \$20,000 to pay tuition fees, and eventually she hoped to get a green card and a well-paying professional job. In the meantime, she worked in a Chinatown restaurant for poverty wages and tips. Her savings and income were enough to see her through school and give her independence. But, despite the hardships of combining full-time classes with work, my friend, who is in her mid-30s, was happy because she had the chance to fulfill a dream.

That was until she heard of Globix Corp. Staff from the web-hosting company, which has its headquarters on the edge of Chinatown, would sometimes come into the restaurant in a celebratory mood. It was near the height of the Internet bubble at the end of 1999, and Globix stock had gone through the roof. To my innocent friend it seemed like a no-brainer. She didn't really understand what these guys did on the Internet, but it sounded smart, they sounded smart, and their headquarters building was impressive. Everyone seemed to be making money out of the stock market, and this was her chance to finance her studies without having to work so hard.

She spent more than half her savings buying Globix stock at about $40 a share toward the end of 1999, and it soared to a high of $67.44 in February 2000. She had a paper profit and this seemed like good reason to celebrate, though she didn't have as much reason as the company's then CEO had. Around that time, Marc H. Bell sold about a third of his interest in Globix, much of which he had gotten from generous stock option grants, for more than $120 million.

A lot of people can fill in what happened next.

The Internet bubble's rupture in March 2000 made investors realize that Globix and companies like it carried a lot of risk for precious little reward. Globix was burdened with a high debt load and a big repayment bill, it had expensive real estate, its world of dot-com clients was imploding, competition had increased, and projections for growth in the web-hosting services market were looking wildly overoptimistic. The stock never touched its February high again, and by the end of that year it had sunk below $5 per share. My friend, who had also invested a smaller amount of money in another technology dud, hung on through the collapse in the hope that the stocks would recover, but they never did, and most of her savings were wiped out. The last I heard, she was struggling to put her life back together in the hopes of pursuing her dream. Eventually, Globix, which declined to comment for this book, saying it was inappropriate given a change in management, went into bankruptcy, virtually wiping out any remaining value in its then-existing common shares. While the company did emerge from bankruptcy in 2002, it still failed to file annual and quarterly results on time, and Bell, who had become the company's chairman, quit in December 2002.

Bell told *The Wall Street Journal* in March 2001 that he sold the Globix shares because his wife wanted him to save some money for the twins they were expecting. "Who knew?" Bell was quoted as saying. "Everyone was talking about Nasdaq and a 20,000 Dow. I just had good timing." As did the twins, it seems. They were born in April 2001. Bell did not respond to emails seeking comment.

Clearly, my friend went wrong in just about every way. She listened to advice from people without checking out their credibility. She didn't even begin to know the meaning of risk, let alone think of diversifying it. She invested in something she hadn't a clue about. And, as for price, she had no perception of what was a good price and what was a rip-off. She wasn't dumb. She just hadn't learned any of the age-old lessons in the often-brutal ways of financial markets.

In this chapter, I intend to take you through some of those lessons. This is the timeless first line of defense against the deceptive, the crooked, and the egomaniacal. Subsequent chapters will build on many of the themes touched on here.

Red Flag 1

If You Can't Understand, Don't Invest

The sage of Omaha, legendary investor Warren Buffett, has always urged investors to define what they don't understand—and steer clear of it. "Paradoxically, when dumb money acknowledges its limitations, it ceases to be dumb," he wrote in a shareholders' letter in 1993. His comment was in reference to the man on the street who did better than the professional investor by putting his money in a fund based on a benchmark stock index. And, in 1999, at the height of the Internet stocks craze, Buffett explained why Berkshire Hathaway didn't own any technology shares by saying that he had "no insights into which participants in the tech field possess a truly durable competitive advantage." He added, "Predicting the long-term economics of companies that operate in fast-changing industries is simply far beyond our perimeter."

Former Securities and Exchange Commission Chairman Arthur Levitt has similarly simple advice for investors who don't understand a company's financial statements. "If management and the statements they produce can't adequately interpret what they mean or what the company is all about to an investor or the investor's adviser, then the investor should simply pass it up," he said in an interview.

Red Flag 2

Friends and Family Don't Like a Company's Products

Two thumbs down from your nearest and dearest is a signal to heed. There are, after all, many products made by publicly traded companies that we not only understand but test on a daily basis. One-time Fidelity Magellan fund manager Peter Lynch says that investors should try to kick the tires before stumping up any cash. That may mean visiting a store, staying in a hotel, talking to friends who work for a company, or noticing which cars are becoming popular.

I know, for example, that US Airways was hit hard by the September 11 attacks—and not just for a month or two afterward. I was surprised it took until the following August to file for bankruptcy, and if anyone had asked me about investing in the company's shares, I would have said no. Why was I so certain? I fly regularly from New York to Boston to see my kids, and for about eight months after September 11, the planes were half empty and the tickets cheaper even after flights had been cut. By the summer of 2002, the airline had more passengers, but the ticket prices were still lower than they had been a year earlier, and some of the abandoned flights hadn't returned. My own experience told me—faster than any financial statements could indicate—that US Airways must have been hemorrhaging badly.

In a similar vein, why was I not surprised that Microsoft's MSN Internet service was losing dial-up customers in the fourth quarter of 2002? Because when I canceled my service around the end of the year, I had to wait a long time to get an MSN representative on the phone, and while apologizing he told me that they were getting a lot of cancellations all at once.

Of course, you can take this to ridiculous lengths. The lack of powdered chocolate to sprinkle on my cappuccino at Starbucks four days in a row is not reason enough to launch a full-scale probe of its financial statements. However, my willingness to buy its stored value cards soon after they were released late in 2001 was an indication of something going on. It turned out that many other customers were buying the cards, and their success helped to drive the coffee chain's share price up about 30 percent in the next few months.

This is not rocket science: We can all do this. It's all useful information that can help investment decisions, though you must always look at a company's accounts as well.

Red Flag 3

A Product or Company Is Hyped by Wall Street, the Media, and Others

It is best to avoid the buzz unless you can see the beehive and smell the honey. The only real reason to risk getting attacked by bees is to get hold of their honey, and too often in recent corporate times it ain't been there. The unwary investor has ended up following the noise and getting severely stung, only to find that the hive hasn't yet been built. There was lots of risk and little chance of reward all along.

James J. Cramer, the former hedge fund manager and now media commentator, gives us a summary of how Wall Street insiders can help create the buzz and end up with a pot of honey for themselves. In his book *Confessions of a Street Addict,* Cramer describes how he went into business with his wife Karen, whom he dubbed the "trading goddess," and how they pioneered a money-making formula for getting the kind of analysts' calls on stocks that they wanted to help them make a profit:

> We developed a style that consisted of figuring out what would be hot, what would be the next big buzz. We became merchants of the buzz, getting long stocks and then

> schmoozing with analysts about what we saw and heard that was positive.

The aim, in Cramer's words, was to "liquidate the stock into the buzz for a handsome profit." The only problem is that many ordinary investors could end up holding the stock that analysts were promoting and Cramer and others were liquidating. The mom and pop investors would then be left wondering why it had sunk.

Red Flag 4

On Wall Street, the Game Is Usually Rigged Against the Small Investor

If you are not part of the Wall Street in-crowd, then you must remember that the odds are almost always deliberately stacked against you.

This was most obvious during the IPO (initial public offerings of stock) boom of the late 1990s, when investment banks and brokers hyped new stocks so that their prices rose to artificially high levels. In some cases, inflated prices were achieved by forcing those getting an allocation of hot IPOs to guarantee to buy the stocks at higher prices once they started trading—a process called laddering. Sometimes, high prices were achieved through biased research reports that urged investors to buy. Those who knew what was going on got out near the top of the market, and those who thought that the demand was real and bought after the stocks had climbed got killed.

For example, Wall Street brokerages will almost always let their top clients know about their analysts' major stock recommendations before they tell the media. That keeps the clients sweet and keeps the commission dollars rolling in from trading they do through the brokerage. So, when a small investor learns through television, radio, or Internet reports that a brokerage has stuck a strong buy label on Blahblah Tech Inc., he or she is well behind an institutional investor who has been trading on that information for minutes, hours, or sometimes even days.

In his book *Trading With The Enemy,* which describes working for Cramer's hedge fund, Nicholas Maier explains how the system worked. "Joe helped me to make money and I was expected to return the favor," he wrote of a Smith, Barney analyst who tipped him off about a recommendation change. Maier would get the information ahead of a wider announcement—provided any trading that resulted was done with the analyst's brokerage.

According to John Gutfreund, the man who was once dubbed "the King of Wall Street," money decides everything there. "I have come to the conclusion now, which I should have done a long time ago, that Wall Street is the ultimate home of mercenaries. There is nobody who cares about the company, the loyalty. They care about the money," said Gutfreund, who quit as chairman and chief executive of Salomon Brothers in 1991 as a result of a Treasury bond bid-rigging scandal.

And mercenaries will only work for you until you are no longer the highest bidder for their services. In *Confessions of a Street Addict,* Cramer indicates that he was able to excel in such conditions—he had large commissions to hand out to the brokers. "If you do a massive amount of commission business, analysts will return your calls, brokers will work for you, and you will get plenty of ideas to make money," he recalls his wife telling him.

The spate of reforms to Wall Street practices, whether by the regulators, or by the securities firms themselves, is unlikely to ever make the playing field level. Remember that many experts say that small investors will always lose out because they don't have the connections, the information, the skills, or the time. "They are trying to compete with highly paid professionals and they wonder why it is so dangerous," said Christopher Mahoney, chairman of the credit policy committee at credit rating agency Moody's Investors Service. "It is extremely dangerous."

Red Flag 5

The Motivation of an Adviser Making a Recommendation Is Suspect

If you are thinking of engaging a broker or adviser to help handle your investing, you should first read about Frank Gruttadauria. He is a former SG Cowen and Lehman Brothers star broker who bilked more than $50 million from his clients in Cleveland, Ohio, over 15 years.

Gruttadauria, who was sentenced to seven years in prison in November 2002, got his employers to send client account statements to post office boxes he operated. This allowed him to then send bogus statements out to clients, overestimating their value by an aggregate of more than $270 million, while allegedly siphoning off their money. It meant that Samuel Glazer, the co-founder of coffee percolator maker Mr. Coffee, received monthly statements from Lehman showing he had $24 million in bonds when he really only had $15,000 left, according to *The Plain Dealer* newspaper in Cleveland, Ohio. The broker himself sent the FBI a letter indicating that he could hardly believe he avoided detection for so long. Remember, this wasn't a stock manipulating boiler room in New Jersey. Gruttadauria worked for major investment banks for a long time.

When dealing with your money and Wall Street, be suspicious and trust nobody. That's harsh advice, but many believe the days are long gone when analysts and brokers on Wall Street had only their clients' interests at heart.

"I went on the Street in 1973, bright-eyed and bushy-tailed, worked for a great firm, high levels of integrity, your word was your bond and I was a customers' man—but now there are no customers' men anymore—it's corrupt," said Herbert Denton, president of Providence Capital, a money manager that aggressively promotes shareholder rights.

In 2002, investors filed a record 7,704 new arbitration claims against brokers with the National Association of Securities Dealers, up 39 percent from two years earlier, alleging such misdemeanors as misrepresenting investments and conducting excessive trades to generate fees and commissions, which is known as churning. So, despite all the noise about risk controls and compliance systems, and all the huffing and puffing about disciplinary action and monitoring by the New York Stock Exchange, the SEC, and the National Association of Securities Dealers, the only regulator who is going to guarantee your investments won't be hived off to a broker's Cayman Islands account is staring back at you in the mirror every morning.

Martin Whitman, the 78-year-old manager of the Third Avenue Funds group, had this to say: "Ever since I have been in business, which is over 50 years, the public has always been taken to the cleaners with one thing or other, some type of promotion. And is that going to end? No!"

Note

Be suspicious; check the backgrounds of brokers and advisers through regulators. See Appendix A.

Red Flag 6

Price Means Everything: A Great Company's Stock May Be Too Expensive

James Grant, the founder and publisher of the newsletter *Grant's Interest Rate Observer,* says that the most important three words in the financial lexicon are "at a price." He continues, "Nothing is true unmodified by that phrase, as trite as it seems." There are times, he says, when even an investment that has a strong stench can be worth it—provided that there is a no-strings-attached giveaway price. Conversely, even the best and most ethically managed company in the world should be left alone if the price of its securities is too high. Grant says he would invest in a company with an egomaniac at the helm if the price was right and its prospects were strong. "There are times when you are paid to make a leap of faith as an investor—but unless you are paid, don't leap."

Investors weren't paid to leap during the Internet-telecom craziness, but they did, lemming-like. A key measurement of how expensive a stock is—the ratio of its share price to the profits per share the company is producing—was often ignored. Instead of the more normal range of about 10–20 for this price-to-earnings (p/e) ratio, many technology companies were trading in the hundreds and even thousands. Many didn't even qualify to have a p/e ratio, as they had no earnings and little prospect of them.

Some top investors can see value in scandal-damaged companies such as Tyco. "We don't say in most cases is there a fraud here? But in the case of something like Tyco, this is part of the analysis," said Bill Miller, whose main fund at Legg Mason has beaten the S&P 500 for 12 successive years. "If they are monkeying with the numbers, if we cannot trust the numbers, how much of the value could they have destroyed, and what could we salvage from this thing?"

Note

Compare price-to-earnings and other ratios with those of similar companies, with the average for the industry, and with the whole market. It is easy enough to do this through services such as *www.reuters.com* and *www.valueline.com*.

Red Flag 7

Don't Get Caught Out by the Latest Fad; It Probably Won't Last

Consider the rise and fall of the collapsible scooter. I bought one early in the summer of 2000 before most people in America had cottoned on to the dorkiest form of transport since the pogo stick. Within weeks of my venturing forth for the first time on the streets of Martha's Vineyard and New York City with my kick-powered gadget from hell, it seemed everyone was buying one and it was the coolest item to possess. Technology companies were buying them by the score for their staffs to zip around campuses or warehouses, and adolescents were holding scooter wheelie competitions.

Within about three months it was over. Some blamed it on the dot-com market crash, and some said highly publicized accidents had turned parents off. Others just remembered how silly they had felt when riding the damned things.

Desperate attempts by the retailers, distributors, and manufacturers to keep the craze going, introducing, for example, features such as motors, suspension, and flashing lights made no difference. From prices around $100 at the height of the craze, many scooters are now selling for $20–30. Bicycle maker Huffy Corp. had initially benefited from the scooter fad and saw its shares more than triple in price, but it then watched them lose most of the gains.

To a short seller like David Tice, the scooter craze was typical of a toy fad that has limited shelf life. “If it is a kid’s product and it just skyrockets, those tend not to have long legs,” he said.

So, if a company is relying on fashion or fad, be wary. People are fickle, and one year’s success story can become the next year’s failure.

Red Flag 8

If You See Major Funds Are Shunning a Stock, There’s Usually Good Reason

Always check who the big shareholders are in a company in which you are thinking of investing, and compare the list to those for its competitors in the industry. If, for example, you find that none of the major telecom funds are invested in a telecommunications company, that is a warning sign. The chances that you have found a gem that they haven’t already scrutinized and discarded as a fake are slim. Providence Capital President Herbert Denton said the absence of big funds is one of the key signs he uses to understand whether a company has problems. For example, mid-sized drug maker ICN Pharmaceuticals Inc. had little overlap in shareholdings with other similar-sized companies in the industry. “The folks that know the industry are saying ‘not this one,’” said Denton.

A cloud surrounded the company’s founder and former Chairman and CEO Milan Panic, a former Yugoslav prime minister who had controlled ICN with an iron fist. Disgruntled shareholders had cited Panic’s costly settlement of sexual harassment suits he faced from employees, a felony fraud plea in which the company had agreed to pay a $5.6 million fine, and a civil suit from the SEC over allegedly fraudulent statements by Panic and the company. The latter was settled by the company with a payment of $1 million and Panic through a payment of $500,000, without either admitting or denying the charges, in November 2002. Panic has consistently denied any wrongdoing, though he finally quit as chairman and CEO in June 2002 after losing a battle for control of the board with shareholders advised by Denton.

If the top shareholder list of a company seems to contain only institutions known for running index funds, that can also be a negative, as it shows that only those who have to own the stock so that their funds match index weightings are on board. The discretionary money has gone elsewhere. The flip side, of course, is that if everybody in the investing world is in a stock, your chances of getting it for a bargain price are limited.

Note

Check company reports and sites such as *www.firstcall.com*'s ShareWatch Web. One site for professional investors, and therefore too expensive for most of us, is *www.bigdough.com*.

Red Flag 9

Avoid Companies That Are Too Reliant on One or Two of Anything

If a company is too heavily dependent on any one aspect of its business, then it can be high risk. The one aspect could be one product, one huge customer, or one major supplier. Or, perhaps the whole company has been built around its founder's name and reputation.

The company that epitomizes the latter problem is media and home products concern Martha Stewart Living Omnimedia. In the first nine months of 2002, its shares lost more than half their value, due mainly to news of insider trading probes into its Chairman and CEO Martha Stewart and her transactions in biotechnology company ImClone Systems Inc. The news led to speculation that she might be indicted and would have to step down from the company.

Stewart, whose magazines, TV shows, and products target homemakers, is such a dominant force that there were questions over whether the company could survive without her. Investors began to realize that Stewart was the company and that there were no meaningful plans for succession, an impression the company had done little to counter. At the time of this writing, in February 2003, it was still unclear whether Stewart would face charges.

Earlier in 2002, investors had also lost some confidence in Stewart's company because the discount retailer that sells almost all its home products, Kmart, had filed for bankruptcy protection and had begun to close stores as it sought to restructure. Early in 2003, it announced further store closures. Again, there were too many eggs in one basket.

So, always ask yourself whether a particular investment is so dependent on one individual that it could sink in value if that person falls under a bus or gets hauled off to jail. Do the same for suppliers, customers, and even whole nations. For example, if you know that a computer maker is becoming increasingly reliant on China as a production source, ask yourself what would happen if there were a major political eruption in that country. You should avoid being surprised. Remember, the crowd is often shortsighted and blind to risk.

Note

Check company filings and media reports for information about customers, suppliers, and distributors.

Red Flag 10

Diversify or Bust: Too Much Money in One Stock May Ruin You

This is just about the oldest advice in the book, and I am not going to spend long on it. Most people know by now that to concentrate all their money in only a few stocks is extremely risky, though clearly an Enron or a WorldCom was needed to get this harsh message through to some. A number of Enron and WorldCom staff, for example, held all or most of their investment dollars and pension funds in the companies' stocks. Well, that was an awful lot of trust they put in Enron or WorldCom management, a trust that was, as we know, betrayed.

So, the lesson is to diversify your equity investments so that they are not all in high-risk technology or telecommunications companies, or in the shares of the entity you work for. You can do far worse than buying an index fund, especially if you have little time to watch over your investments or to comb through lists of mutual funds. An index fund will rise and fall in line with the stock market average it is tied to, but the fees are usually significantly lower than for a stock-picking fund.

You should also have a significant percentage of your funds in other assets, such as real estate, cash, and bonds. That way you can limit your losses in a bear market of the kind we have seen in recent years. This is particularly the case when you are within a few years of retirement.

Ejecting at the 11th Hour

If an investor still hasn't ditched a stock by the time the events outlined in the following red flags have come to pass, then it may be too late for a graceful exit. I have given all these warnings three flags.

Red Flag 11

A Company Files for Chapter 11 Bankruptcy Protection

Stockholders almost always get wiped out when a company declares bankruptcy because debt holders get paid off first. This requirement often means that when a company goes into liquidation, there is nothing left with which to pay stockholders. When a company reorganizes under Chapter 11, the creditors will often end up owning most of the equity, leaving the previous stockholders with a much smaller stake, or even no stake at all. So, if you own shares in a company and there is speculation that it is going into bankruptcy, it is probably best to bail out. Waiting until an announcement of a bankruptcy filing to sell your shares will be leaving it too late. The speed with which companies such as Enron Corp. and Kmart Corp. went into bankruptcy in December 2001–January 2002 caught many investors by surprise, though in both cases there was enough time to get out if people had taken note of some of the warning signals detailed in this book.

Note

The bond market often provides an early signal of bankruptcy risk. See Chapter 10.

Red Flag 12

The SEC Launches a Full-Scale Probe into Possible Securities Fraud

Given that the authorities are often late on the scene—well after others have suspected that the books are being cooked—this red flag is a bit like the shark warning sign that is put up when you have already waded into deep water. Companies do survive investigations by the SEC, Congress, and the Department of Justice; however, a securities fraud probe usually takes many months (if not years), and during this time, the company's shares may not see any gains.

A regulator's investigation is also usually symptomatic of much deeper problems. Copier maker Xerox, for example, agreed to pay a $10 million penalty to the SEC in 2002 and to accept an injunction for violations of antifraud, reporting, and record-keeping provisions of securities laws, but the company did not admit or deny allegations made in a complaint by the regulator. Much worse than this punishment was its subsequent need to restate financial results for four years. SEC Director of Enforcement Stephen Cutler said the company "used its accounting to burnish and distort."

Such probes also tend to increase the amount of civil litigation brought against a company by investors. To stay with a stock through this, you really have to have faith, and it may not be logical faith.

Note

Official announcements can be found on the SEC's website: *www.sec.gov*.

Red Flag 13

The CEO or Another Top Company Official Is Arrested

It is also generally too late for investors to protect themselves against a corporate mugging when they hear that a top executive has been arrested. Usually, the company concerned and its stock have collapsed by the time law enforcement officers have cuffed another one-time high-flier in his New York apartment in the early hours of the morning. For example, members of the Rigas family were arrested on securities fraud charges about a month after their Adelphia Communications cable company filed for bankruptcy protection in the summer of 2002. Tyco's share price dropped 27 percent the day it was revealed that CEO Dennis Kozlowski had quit because he was about to be indicted on the first charges he faced, which were for alleged tax evasion on art purchases (the more serious charges were filed some weeks later). By that time, though, the company's stock was already worth less than half its value at the beginning of 2002.

Red Flag 14

A Company's Shares Are Delisted by a Stock Market Such As the NYSE

Exchanges such as the New York Stock Exchange don't like to delist stocks because listing fees are a critical source of revenue. So, when the day finally comes, it usually means that the company being delisted has either committed some terrible misdemeanor or its stock has sunk below $1 and stayed there for a long time, resisting any attempts to resuscitate it. Either way, investors who have stuck with it have almost certainly lost out. The NYSE can issue a delisting warning if a stock is below an average of $1 for 30 days, after which the company usually has about six months to persuade the exchange that it can get the price back above that level. The exchange can also delist a stock for breaching other listing rules, though this happens much less often. The Nasdaq stock market allows a company 180 days to get its stock back above the $1 mark if it has been below for 30 consecutive days; that is double the 90 days that applied before the September 11 attacks.

Red Flag 15

A Company Does a Reverse Stock Split to Remain Listed

A reverse stock split is often a last desperate attempt by a company seeking to prevent a market from delisting its stock, and it often fails. This strategy is like shuffling the deck chairs on the Titanic, as Noah Blackstein, vice president and portfolio manager at the Dynamic Power America Fund, told Reuters when AT&T Corp. announced a reverse stock split in April 2002. Companies that use the method are almost certainly already in deep trouble, with a share price already down a long way. For example, in December 2002, telecom equipment maker Lucent Technologies announced plans for a reverse stock split of anything from 1-for-10, 1-for-20, 1-for-30, or 1-for-40 by February 2004. Its shares fell about 8 percent the day after the announcement to reach $1.74, and at that stage had lost more than 97 percent in about three years.

Note

If a stock heads close to or below $1, consider delisting to be a possibility.

Red Flag 16

A Company Is Facing a Large Number of Class-Action Lawsuits

If the class-action lawyers are circling a company like vultures, then the stock has probably already been shot to pieces. The lawsuits tend to be reactive, so it may be too late to see this as a signal that will save you much money. Even so, as an eleventh-hour alarm, it should be heeded.

Note

There are web sites that specialize in analysis of class-action filings, such as the Stanford Law School/Cornerstone Research site at *http://securities.stanford.edu/index.html*.

Red Flag 17

A Prominent Short Seller Has a Company in His or Her Sights

Investors who hear that a prominent short seller is gunning for a particular company should take heed. Short sellers are far from always right, and their timing can sometimes be askew. But when they do hit the nail on the head, the results can be devastating. We will see later how short sellers were right about Enron and Tyco—months or even years before anyone else. Before you dismiss news that a short seller is hovering or before you believe a company denial, you should do your own research to see whether the short seller's story stands up to scrutiny.

You can follow what short sellers are doing by examining the data issued by major U.S. stock markets every month, although the figures are about a month old. Monitor short sellers' actions on both individual stocks and the market as a whole. A rise in the percentage of short positions on an exchange or in a stock may indicate that sentiment is turning bearish.

Note

You can get the latest monthly report for the New York Stock Exchange by going to *www.nyse.com* and selecting the press room area. For Nasdaq companies, visit *www.marketdata.nasdaq.com*.