This is a simple issue.

It used to be that you couldn’t short a stock unless there was an uptick. The idea was that this uptick rule would prevent short sellers from piling on a stock and driving the price down. Then the uptick rule was removed. It became permissable to borrow shares of stock and sell them whether or not the stock had ticked up or not. The result ? Nothing. Not a darn thing changed.

Good companies operated their companies well. They recognized that short sellers just created future demand for their stocks. If they pushed the price down to new lows, it just created an opportunity for investors to buy the company at cheaper prices. So be it. Good companies aren’t defined by their stock prices, they are defined by their operations.

On the flipside are poorly managed companies. Poorly managed companies always presume the current business environment will stay the way it is. The big investment banks thought they could always raise capital and deploy it at higher returns. Which is a great model to lever up to squeeze every possible nickel out. It makes it easier to get your bonus and makes shareholders who only pay attention to the stock price happy.

Except that leverage is risk. Always has been, always will be. When you dont manage your risk well, you pay the consequences.

The problem with the likes of Lehmans, Bear Stearns et al, wasn’t that their stock prices were pushed down, it was that they had become myopic and overly leveraged. They had not considered all possible negative scenarios. When they were forced to write down assets and couldnt get access to loans because no one trusted their balance sheets, they were without capital. When they were without capital, they were SOL. Deleveraging brought their entire business models crashing down along with their stock prices. Lehman disappeared, the rest got government bailouts or were pushed to be bought out.

If they had not over leveraged, the price of their stock would not have mattered. If they had managed their risks properly, their stock price would not have mattered. The uptick rule had nothing to do with their failures. Management did. To blame it on the uptick rule is ridiculous. Companies that hadn’t overlevered and stuck by their lending and business principles got along just fine. Their stock prices did just fine as well. It really as simple as that.

Does anyone really think that even if there was an uptick rule and stock prices were not as volatile and even possibly higher, that anyone would have given Lehman’s capital in a private raise with all the uncertainty about their balance sheet ?

Put another way, if the uptick rule drove down prices, it should have been EASIER for the financial companies to raise money. Smart investors would have recognized the strength of their balance sheets and gladly jumped at the chance to invest money at prices depressed by those nasty short sellers capitalizing on the lack of an uptick rule.

That’s not what happened. What happened is exactly what should have happened. Good companies did well. Poorly run companies didn’t. Those in the middle got lucky and bailed out. The uptick had zero impact.

Thats not to say short sellers didn’t pick on the financial companies. Of course they did. They did so because they were poorly managed. They were right

When you hear someone talk about bringing back the uptick rule as a solution. Laugh. Then tell them “Larry Bird is not waking through that door”.