I short stocks. I make money shorting stocks. Some of my best friends are the stocks that became worthless over the years and I never had to cover.

I short stocks because I'm a firm believer that in a universe of more than 10k public companies, not all of them are well operated. I also believe that since short selling is rarely if ever offered as an option by traditional brokers to their customers, there is always going to be a bias towards demand trying to push the price of a stock up. That in turn creates an opportunityfor short sellers who get to take advantage of that upside bias.

Of course there are risks to short selling. If you don't fully understand what you are doing, you can lose more on the short side since a stock can only fall to zero, but it can go up to any price. To me, that just gives me reason to do more homework, not to shy away.

I thought this blog entry would be timely because the SEC has recently taken steps to stop abuse of the rules of shorting. One of which is that you have to actually borrow shares before you can sell them (if you don't know what this means, just ask your broker). Some short sellers abused the process by giving sell orders to their brokers for stocks they don't own, or have not borrowed. The SEC decided to finally enforce the rule and make brokers confirm that the shares have been borrowed and delivered. Some short sellers don't like that this rule is being enforced.I actually like it.

I like it because it balances the playing field. Sometimes when I, or anyone, borrow a stock in order to short it, we have to pay a fee to borrow that stock. If a stock is heavily shorted, and as a result, difficult to borrow, the owners of the shares will only lend them to you if you pay them some percentage of the stocks value. It may be 2 pct, or go as high as 15 pct on an annual basis. The "VIG" becomes part of the cost of doing business. If I'm paying the VIG because I think the companies prospects are so poor it's worth it, then I want everyone playing by the rules.

Why? In case I'm wrong about the stock. If by chance I'm wrong (and honestly, it doesn't happen very often), naked shorts increase the demand for shares of stock in the company beyond what it legally should be. How can that be? Because even naked shorts have to cover sometime. Particularly if the stock is moving up. Even though they didn't play by the rules, their brokers will still apply the margin rules against the short sellers accounts. If a stock moves hard against them, they will cover. Their covering stock, moves the stock price higher, which in turn hurts my short position.

I also want them playing by the rules in case I own a stock that is heavily shorted. Sometimes the shorts are wrong. If the demand to short the stock is high, and I think the shorts are wrong,forcing the shorts to borrow the stock first, can increase the demand to borrow the stock I own andpush the VIG higher. Nothing better than owning a stock that other shorts have wrong. I can be the one charging 10 pct or more VIG , and make money on the long side.

So mark me down as a short seller who thinks naked short selling is wrong.

That said, let me also say that when we had broadcast.com, and this would be my position if I ran a public company today, other than making oodles of money and having lots of demand for your stock, there was and is nothing better for the price of a stock than having it shorted. It doesn't matter if the shares are shorted naked, or fully borrowed. Doesn't matter a bit.

The more shorts, the more shares shorted, the morepent up demand there is for the stock. For a company that is well run andoperationally successful,short shares are like an insurance policy to protect the downside for the price of your stock and more likely push the stock price ever higher.When we had broadcast.com I used to beg people to short our stock. If they didn't like what we were doing I would actively suggest to them that they short the stock. Sure, it might have slowed the rise of the stock in the short term but who cared. I knew we were going to be able to hit our numbers, so why not. If we did our jobs, it just meant they would have to cover the stock and in a down market, that helped keep the price up and in an up market, that could cause the stock to run. Both very good things.

Which leads to one of the things I look for when I short a stock.

The louder a company complains about the shorts, the worse the company. Companies bitching and moaning about shorts trying to hit their stocks are companies that are far too worried about their short term stock price andare looking for an excuse to give their shareholders.

A smart CEO is out there telling shareholders that the numbers will speak for themselves, that the company is doing what we set out to do, and if you believe in what we are doing, buy the stock. If you don't, you probably shouldn't.

A company with problems finds a reason to talk about anything but the company as a reason for the stock not doing well. It reminds me of the music industry. They didn't want to address what really was causing sales to fall, so they blamed it all onthe internet and piracy. Piraphobia in their case, Shortophobia in the case of public companies. Rule of thumb, IT'S NEVER THE SHORT SELLERS, IT'S ALWAYS THE COMPANY.

Short sellers also provide a 2nd set of eyes looking from a completely different perspective. When a short seller called, I would always talk to them. It's possible they know something you don't. Maybe there is a problem with your product or service that they have heard from one of your customers that hasn't filtered to you. The short sellers give you a heads up about that problem and the chance to go fix it. In essence, they are giving you a challenge and saying, "if you can correct what we think is wrong, or explain to your shareholders that we are wrong on a certain subject (doesnt matter if its real or made up),we are going to have to buy shares of your stock to cover our shorts". How in the world can that be a bad thing? If they are wrong, you tell them why. If they make something up, you tell the truth. That simple. Then they buy your stock to cover.

So if you own a stock, and the company or other shareholders are blaming the share price on shortsellers, run away. Quickly. You are in the wrong stock. If you are short that stock, keep on digging. There is probably a lot of shit buried in the company books waiting to be discovered if you haven't already.

Short Selling is an important part of the market. If you manage your own stock portfolio, not understanding how it works is the equivalent of playing basketball and having one hand tied behind your back. You are going to be at a huge disadvantage

*************Part 2********************** Posted Feb 26, 11:30 pm ***

I want to add a part 2 in response to a post from Bob O'Brien. – Bob, you are confused and use all the terminology of a scam artist.

Let me tell you how it really would work.

Let's say I run a public, thinly traded company, andI think my stock is being pushed down by dirty boys using naked shorting. Let's also say I have a very real need for capital.

If it's my company, and I know its a good company, be it REIT, Widget company or any other…I take avail of my options, which are plenty.

1. If my stock price is pushed down far enough, and again, we are talking thinly traded companies that you refer to, it will take far less money to do a buy out, interest rates are cheap. I just go to the bank, show them how wonderful my company is, that the stock is incredibly undervalued and we take it private. The fact that there are naked shorts make it even more attractive. You announce the deal, you watch the stock price go through the roof as your shareholders are handsomely rewarded as the shares go north as the naked little beasts try to cover their shorts.

2. IfI don't want to take it private, and where your argument turns into total bullshit is that there are private equity firms all over the country looking for deals. Undervalued stocks. They aren't capital constrained. They are opportunity constrained. It's not like all the little naked short funds are the only ones that scan the universe for thinly traded, highly shorted companies where the shorts are wrong. Me, anyone with sense, their uncles, brothers and the funds down the street all look for these situations and salivate over them. I bring them in and ask them to buy up the stock. They do, they make a boatload of money and so do my other shareholders

3. IfI don't want to do a secondary because my stock is low, rightfully or wrongfully,I go to the bank and borrow money. Banks give lines of credits based on operating performance of the company. Sure a higher stock price can let you get a little lower interest rate, but it won't make the difference as to whether you qualify for the loan or not. The capital is out there for companies with strong performance.

I know you are active with NFI. It has a market cap (according to Yahoo) of 907mm dollars before debt. With all that cash they supposedly generate why haven't they gone to their local bank and or private equity fund and borrowed the money to take the company private?

Just what they pay in dividends could easily cover principle and interest on a Billion Dollars or 1.5B or more in a buyout price. PLUS, if there as many naked shorts as you say, in addition to the real shorts, that price would run so high, so fast, you guys would make a killing. The only problem with this approach, is that a bank cares about real operating earnings. If they are there, it's an easy deal. If they aren't and if the company doesn't do it, some Warren Buffet wannabe will, if its a real company with real value.

Wasn't Kmart a heavily shorted stock? The value was there, a smart buyer recognized it and the stock went to the moon, rewarding all those who believed, and crushing those that didn't. That's what happens when real companies have depressed stock prices.

Like I said, if there is value in NFI or any company to the degree that you and others say, then where are the funds with billions, or those with a couple hundred million and good credit, coming in and buying the company outright? With all the naked shorts and legit short positions out there, everyone and their brother who believed in the company would make far more than they would if the naked shorts just disappeared.

I wanted a reason to buy shares in NFI. I could get a dividend, I could lend the shares to a shortseller and make more than 10 pct. Between the two, you would think its easy money. I even looked at buying puts, to protect my long position, but the puts were SOOOOO expensive, it wasn't worth it. When I did my homework, everything about this company scared the shit out of me. There were red flags every step, the biggest of which was your NFI website and all the talk about how the shorts are hurting the company.

Now, I wish I could short the stock, but it’s impossible to borrow.

So Bob O’Brien, I just gave you several ways that your friends at NFI can protect the interests of their shareholders…let see what they do.

For anyone else out there reading, when a company complains about shorts, run as fast as you can to sell the stock.