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Naked Short Selling and Market Returns

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Abstract

Boulton and Braga-Alves study persistent failures to deliver (fails) to better understand naked short sellers' trading strategies, their ability to profit from their trades, and the market's reaction to information about their activities. Contrary to recent claims that naked short sellers are momentum traders who drive down stock prices, they find that returns are typically positive just prior to periods of increased naked short selling that result in persistent fails and that returns generally remain positive for several weeks afterward. Their results also suggest that stocks that experience persistent fails are susceptible to short squeezes as shares move from a normal state in which short exposure is established by borrowing and selling to a hard-to-borrow state in which fails become a more attractive option for establishing short exposure.

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