

Hedge funds are 'the scapegoats'

Lisa McNamara | *July 17, 2008*

AUSTRALIAN hedge fund players have slammed US moves to curb some forms of short selling, saying hedge funds were being made the scapegoat for falling markets.

The US Securities and Exchange Commission's decision was a "knee-jerk reaction" to financial volatility, observers said.

John Corr, investment manager at hedge fund Fortitude Capital, said the SEC was attempting to regulate something that had been occurring for years.

"Short selling is part of the price-finding solution; sure, at times it gets overdone, but when leveraged buying pushes prices to ridiculous levels, no one complains," Mr Corr said.

"But if short selling is one of the things that's pushing prices to too low a level, people want to complain about it." Paul Fiani, fund manager at Integrity Asset Management, said the measures might relieve some nerves, but he questioned the assistance it might provide to the big financials such as Freddie Mac and Merrill Lynch.

"It seems that some financial institutions are becoming protected species, which can take on any amount of risk, reward their executives obscenely and then rely on the Government to bail them out and provide protection from short sellers," Mr Fiani said.

Another hedge fund dealer said: "They're pandering to the companies with the biggest voice and they're saying, 'if it wasn't for short sellers then these prices would be a lot higher'," the dealer said.

"They think that by stopping short selling it's going to stop these companies going down, but what about the people who own the shares? They're going to continue to sell them -- they can't stop that." Mr Corr said the US moves would do little to stop market volatility and could, in some cases, accelerate price falls.

"Say, if ANZ was down 1 per cent one day and Westpac was up, a hedge fund would classically buy ANZ and sell Westpac short and just run that as a position.

"That tends to reduce volatility -- but without that you're going to have one less buyer of Westpac on a down day and one less seller of ANZ on an up day, and the prices will just go down further."

The new US measures -- under which investors would be required to borrow stock before short selling and taking the securities off the market to effect the trade -- were already operating in Australia.

"The new rules are very similar to the informal rules here," Mr Corr said.

"The US is trying to bring into line what happens in the rest of the world, certainly in Australia, where it's very unusual to have very large positions without stock being borrowed."

Trying to regulate what is the "grey area" of short selling would probably lead to more legislation and more bureaucracy, observers said.

"When markets fall, people look for every excuse as to why they're falling, and it's easy to blame short sellers because people are making money from it," Mr Corr said. "The reality is, anyone who short sells something has to buy it back, so it actually creates future demand for the securities, among other things."