Introduction to Short Selling

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What is a Short Selling?

- Short selling (aka, 'shorting') is the act of borrowing a security in order to sell it at today's prices, and buy it back later to repay the loan.

- Shorting is generally intended to accomplish one (or both) of the following:
  - Generate a profit for the investor due to a decline in the price of the security between the sale and the repurchase to terminate the loan
  - Provide a hedge to a portfolio by shorting something that is highly correlated to an investors portfolio

- Shorting requires several steps:
  - Borrowing the security in question (this requires the investor has a taxable account with margin support for borrowing)
  - Paying interest to the broker / lender of the shares (interest rate varies daily)
  - Selling the borrowed security to generate cash
  - Investing cash proceeds
  - Buying back security to repay loan and close out the short transaction

Short Selling – A Visual

(1) Investor borrows stock to short from broker. Investor begins paying interest for stock loan

(2) Investor sells borrowed stock into market for cash proceeds. Continues paying interest to broker plus additional payments to cover the stock dividend payments.

(3) Investor buys stock to repay brokerage firm loan. At this point investor realizes a profit or loss depending on what the price of the stock did.