Best Shorts

Discussion by Ekkehart Boehmer

ABFER paper 2021 Annual Meeting

5:30 – 5:50 Presentation

5:50 – 6:05 Discussion

6:05 – 6:15 General Q&A

Basic structure of this paper

Identify informed traders by following their trades. Extract the information from their trades based on short conviction.

Then mirror their activity.

Compute aggregations of these measures as needed.

Compared to other papers, this extraction process is uniquely possible because the authors can observe trading by a certain set of typically informed traders--short sellers.

Basic structure of this paper

These data have two key features—some stocks and markets must notify the regulator and/or the public when their short positions cross certain thresholds.

Second, these notifications are at the trader level, so we can infer directional activities from these data.

Alpha or other explanation?

- Results so far capture short strategies.
  - Is the result unique to short sellers?
  - or would the same alpha obtain with another set of uniquely informed traders--such as insiders?
  - For example, Boehmer, Sang, and Zhang (WP) show evidence supporting the latter.

- Let's say I'm convinced that the authors are right in that their alpha estimates are real (although vw tests don't work).
  - But what do we learn from this observation?
  - Or, what type of information are we missing that other traders still see?

So what can explain the alpha in this paper?

- Information not captured by the defenses in this paper.
- Controlling for risk and all other risk-related variables that the paper hasn't looked at too closely.
- Results are not due to costs, risk, fees, factor risk, …

- Without an economic story it's not clear what is happening.

Let’s look at liquidity more closely

It’s in the tests of this paper.

Let’s look at liquidity more closely

First, the main tests in Section 5.1 and others suggest that incorporating transaction costs lowers the alphas in this paper significantly.

Second, the key observations come from event studies in F6 and F7: CAR is significantly positive. So here are two variables that are directly driven by the authors’ conviction measure: CARs and netting of transaction costs.

Why would we expect liquidity to play a key role in this paper?

- For one, the authors' strategy involves daily (!) rebalancing. We must look at this more closely.

Liquidity and smart short sellers

There are always two sides: liquidity is provided on one side and used on the other side–so higher transaction costs may benefit market makers, but will increase transaction costs for short sellers and other traders.

In fact, this relationship may change over time (Boehmer, Duong, Huszar, JFQA 2018 also make related points.

Did we learn more yet?

- The conviction approach generates alpha.
- If there is one feature not looked at, then it is liquidity (in this paper).
- Liquidity plays an important role and perhaps there’s room for focusing the paper in this direction.

Last slide: More general suggestions

- Replicate all with U.S. data and understand differences

- Complete the liquidity story
- Understand net short vs overall short

- Good luck with your paper!