SHORT SELLING EFFICIENCY

Every time Dr. Dayong Huang publishes a paper, the world learns a little more about the nature of the U.S. stock market.

"For years one thing that always intrigued me was what determined the value of stocks," says the UNC Greensboro Bryan School professor of finance. "But from the early stages of my research, I was more theory focused and never paid enough attention to what the traders actually do."

Huang has shifted gears in recent years, focusing on the relationship between the market and various types of traders – whether retail traders, or institutional traders such as hedge funds. He recently co-authored the paper "Short Selling Efficiency" in the Journal of Financial Economics which analyzes short selling as a predictive mechanism.

"Short selling is a trade that bets on the decline on the stock prices and is an important player," says Huang. "So short selling is often used on overpriced stock, which is the case on average, but there are plenty of times that short selling is not allocated to the correct stocks."

Throughout his research, Huang monitored thousands of stocks, attempting to calculate and explain future aggregate stock market performance based on the intensity of short selling activity by checking if short selling is placed on the correct or overpriced stocks. Huang said the intensity of short selling at any given time matters to the market, and the practice has predictive power that is stronger during periods of recession, high volatility in the market, and low public information. It performed better than simple aggregate short interest as it used a different weight among individual stocks.

For any retail – or nonprofessional – investors reading, Huang notes that hedge funds conduct the lion's share of short selling and wouldn't recommend the practice to the layperson. He also notes that the audience for his papers tends to be investment professionals and relevant institutions.

Huang, who earned his PhD in financial economics from West Virginia University in 2005, says he has been trading throughout his academic career if only to gain practical insights into what he teaches his students.

"I decided to pick up trading because I teach it," he jokes. "There are good things in the textbook, after 20 years I've learned the market is formidable so an average investor needs to consider seriously simply holding the market. Trying to time the market or select a few stocks to buy or short sell is difficult."

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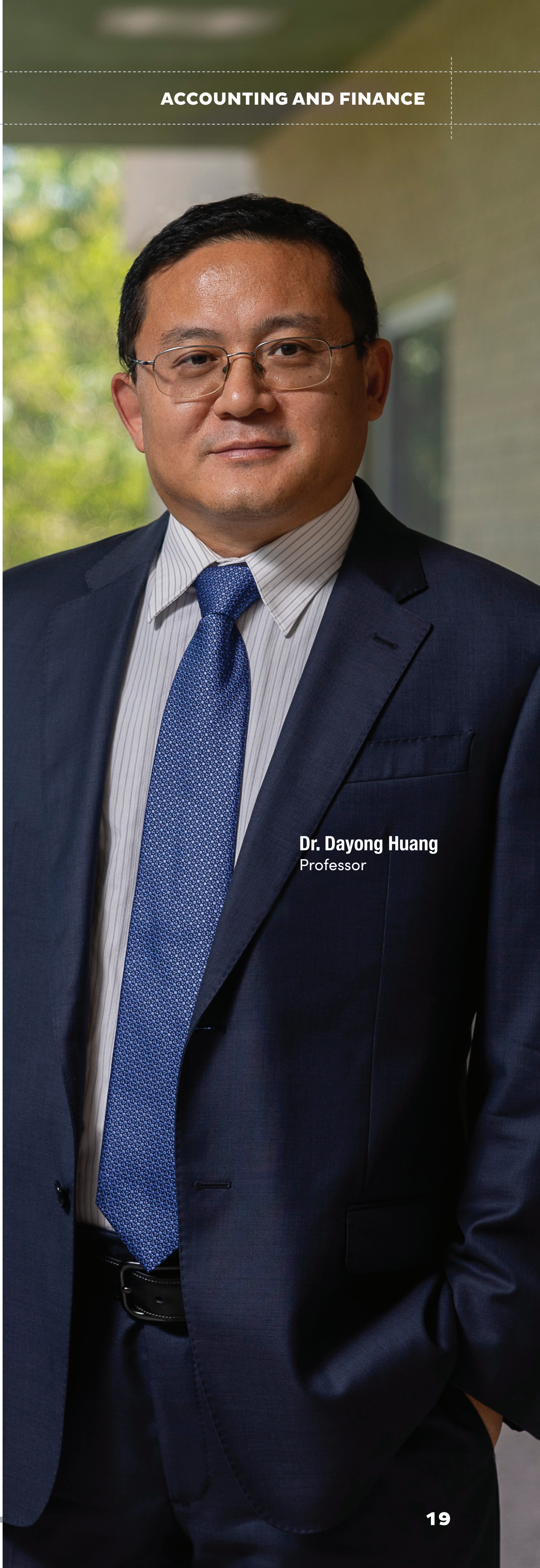

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