

15 June 2020

Thematic

Should We Fear the Return of Short Sellers?

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In anticipation of the lifting of short selling ban on the 1st of July 2020, we attempt to answer the question – Will the return of short sellers cause markets to falter? Based on study of 62 out of 215 short-able stocks; we think it's highly unlikely.

For the uninitiated, there are 4 kinds of short selling in Bursa:

- (i) Intraday Short Selling (**IDSS**),
- (ii) Day Trading (**DT**),
- (iii) Regulated Short Selling (**RSS**) and,
- (iv) Permitted Short Selling (**PSS**).

Most of the short volumes in Bursa are actually dominated by IDSS and DT whereas RSS and PSS only make up a fraction of the short volumes. Hence, our study revolves around IDSS and DT short sellers – the one that matters. Through our findings, there are identifiable patterns that we can observe. **More often than not, key findings indicate:**

1. Short sellers are not the first to trigger a sell off. The triggers are typically event driven i.e. negative news flows/poor earnings.
2. Short sellers have a higher tendency of shorting stocks which (i) are in a downtrend, (ii) have smaller market cap and (iii) have lower absolute share prices. We define a down-trending stock if their stock prices are < 200-day simple moving average
3. Typically, we see short sellers emerging in huge volumes when (i) a down-trending stock breaks down lower and continue its downtrend trajectory **and** (ii) when a down-trending stock or sideways-trending stock tries to break out higher.
4. This means that (i) during a sell down, short selling could exert downward momentum and possibly exacerbate the fall, and (ii) short sellers would resist share price recovery making any potential rebound take longer or require more good news to recover.
5. Occasionally, we do see short interests spike in an exponential share price rise (*too high too fast scenario*). We note that this phenomenon is first triggered by a seller of a long position (in large amounts), which then prompts the short sellers to join in, adding to the volatility.

Essentially, the majority of short sellers in our market are (i) technical/momentum-driven and (ii) downtrend bias. Therefore, it is safe to say that short sellers (with exception to RSS) will not short a stock just because stock prices are high or its fundamental valuations (eg. PE or PBV) are overvalued. Safe to say, short sellers would never derail an uptrend trajectory. However, we caution that short sellers could amplify a sell down (through momentum) IF long position holders unwind their position in large volumes (regardless whether the stock is in downtrend or uptrend).

Be aware of these names. In the Bursa's universe of short-able stocks (as of 29 November 2019), we have identified 7 names which have recorded high short participation rates historically and are currently in a downtrend (*making them a prime target for short sellers*). Thus, we believe the lifting of short selling restriction could subsequently cast an additional layer of selling pressure, making any potential share price recovery slightly more difficult. These counters are **UMW, BAT, Sapnrg, Airasia, E&O, Armada, and Dayang**.

Study of short sellers in Bursa

All together, we ran through a sample size of 62 out of 215 Approved IDSS/RSS securities from Bursa to come out with our findings.

First, we lay down the **key main differences** between the 4 different short-selling mechanisms in Bursa for reference.

Figure 1: Short sellers

Types of shorts	IDSS (Intra-day short selling)	Day Trading (DT)		RSS (Regulated Short Selling)	Permitted Short Selling (PSS) (related to ETFs) Was NOT banned by Bursa
		IVT (Investment account trader)	PDT (Proprietary day trader)		
Participants	Open to all retail and institutions. Retail and foreign institutions dominate this space.	Dealer's representative ie a licensed trader attached to a Participating Organisation (ie Kenanga, Affin Capital etc)	Dealer's representative ie a licensed trader attached to a Participating Organisation (ie Kenanga, Affin Capital etc). Needs to have at least 5 years experience as an IVT before can apply to be a PDT. Less than 200 in Msia	Open to all retail and institutions. But foreign institutions dominate this space.	Registered Market Maker under Bursa
Shortable stocks	Bursa RSS & IDSS Approved Securities	Bursa RSS & IDSS Approved Securities	All stocks in Bursa except Ace Market	Bursa RSS & IDSS Approved Securities	Underlying constituent securities of exchange traded funds (ETFs)
Rules ("At tick rule" means can only sell at best ask price)	Not subject to any tick rules. However, on the 17/3/20, due to the extreme volatility amidst the Covid-19 pandemic, Bursa has subjected IDSS to the "at tick	Not subject to any tick rules. However, on the 17/3/20, due to the extreme volatility amidst the Covid-19 pandemic, Bursa has subjected DT to the "at tick rule"		Subject to "At tick rule"	Not subject to any tick rules. However, on the 17/3/20, due to the extreme volatility amidst the Covid-19 pandemic, Bursa has subjected PSS to the "at tick rule"
Holding Period	Intra-day	Intra-day		Indefinite as long securities are borrowed through Securities Borrowing and Lending (SBL) or purchased through Islamic Securities Selling and Buying – Negotiated Transactions (ISSBNT)	Indefinite as long securities are borrowed through Securities Borrowing and Lending (SBL) or purchased through Islamic Securities Selling and Buying – Negotiated Transactions (ISSBNT)
Trading strategy	Technicals/ momentum	Technicals/ momentum		Sophisticated trading strategies ie long/short, arbitrage etc	Arbitrage when ETF value is lower than the underlying securities in the ETF

Source: Kenanga Research, Other sources

We will be ignoring Permitted Short Selling (PSS) in our study as it is more correlated to the ETF markets.

The “At tick rule” means that RSS short participants can only sell at the “best ask” price – prohibiting them from triggering a sell down. The most they can do is cap share prices from going up by supplying a huge number of shares at the best ask price. That said, we note that RSS short volumes are extremely low as compared to IDSS/DT. Hence, we believe RSS short sellers actually have very little influence over our market.

IDSS/DT is more potent when it comes to a sell down as IDSS/DT can sell to “bid prices”. Nonetheless, as of March 17th, Bursa has subject all short-selling activities in Bursa to the “at tick rule”. It is still not known if the “at tick rule” will be lifted as well on the 1st of July 2020.

The Key Ratios in our study

In our analysis, we identify patterns by observing two (2) key items:

1. Participation rate (%) of short sellers:

$$\text{Short Participation Rate (\%)} = \frac{\text{Total Short Volumes}}{\text{Total Daily Volumes}}$$

where we only filter out participation rates of >5% (which we deem more material).

2. Absolute volume of short sellers (units in millions)

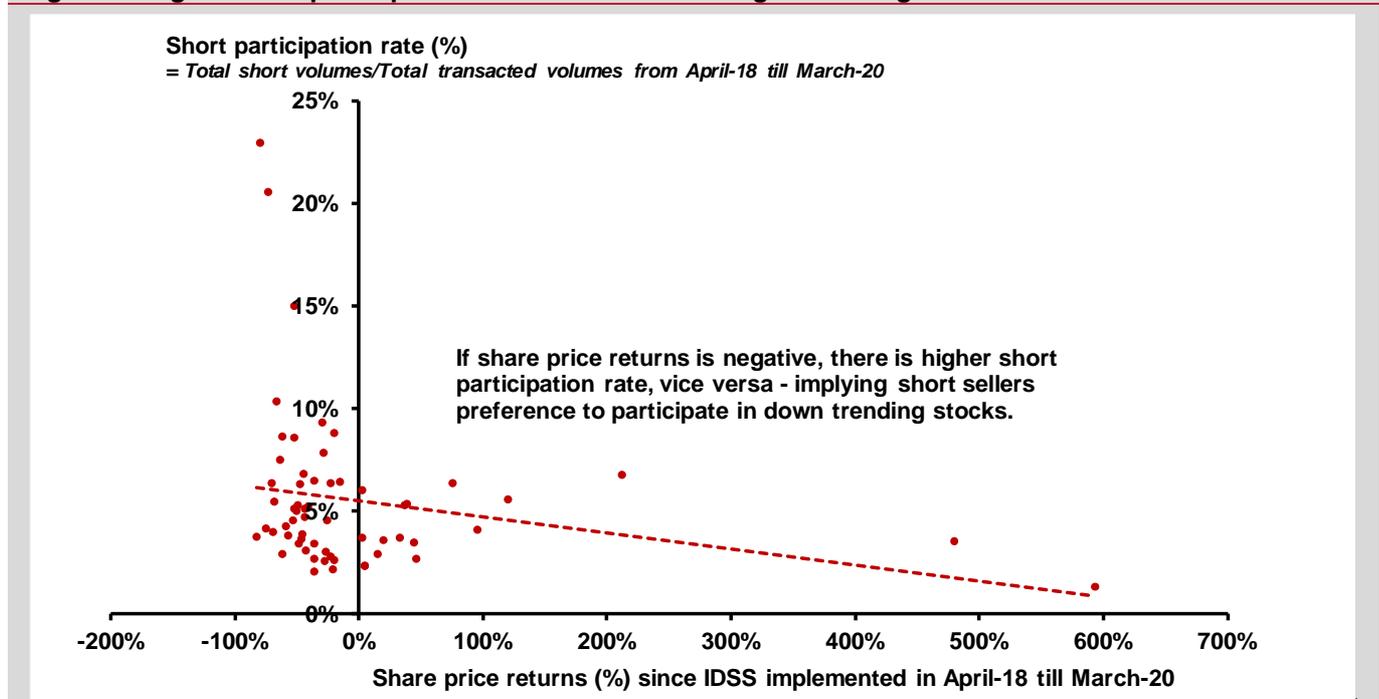
The Characteristics of IDSS/DT short sellers

In all of our observations, short selling was never a trigger causing share price to fall. Share price fall is typically triggered by negative event/bad news flow/poor earnings which will then induce the short sellers to join in.

Our study indicates that short participation rates (%) have an inverse correlation with (i) share price returns, (ii) market cap and (iii) the absolute share price/share. (refer to Figure 2, 3, 4)

This means that the short sellers have higher tendencies to short (i) a down trending stock, (ii) smaller cap companies and (iii) stock of a lower-level absolute share price.

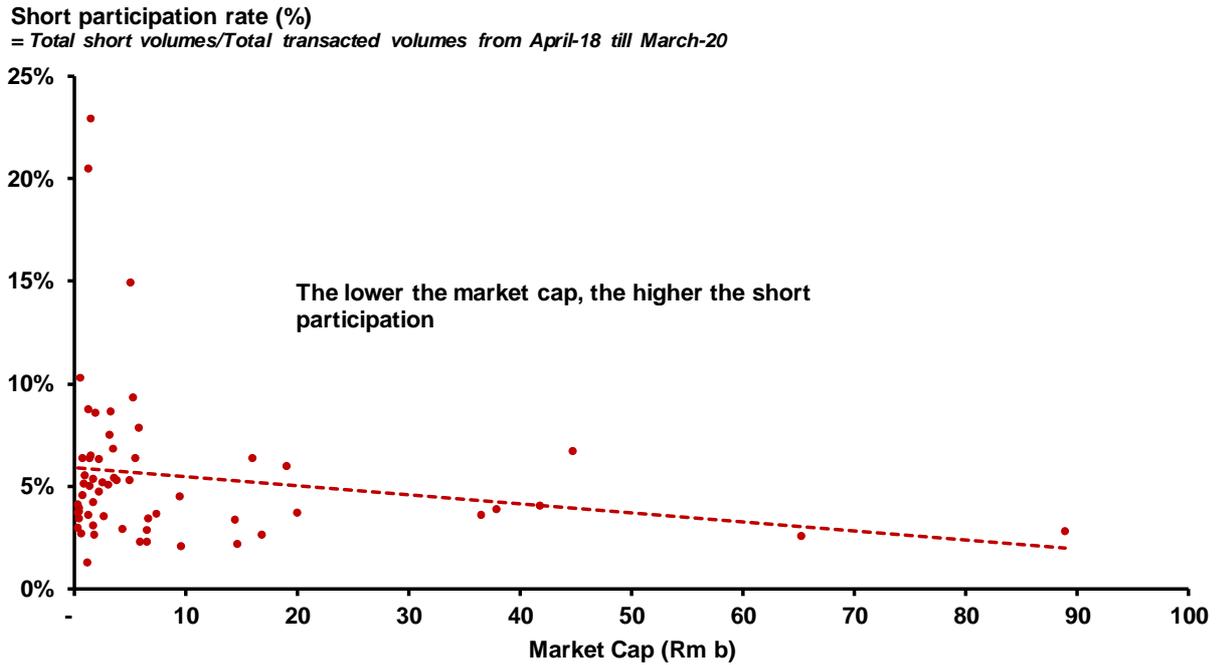
Figure 2: Higher short participation in stocks that have registered negative returns



Note: we use April-18 as the start date because it was when IDSS commenced operations

Source: Bloomberg, Kenanga Research

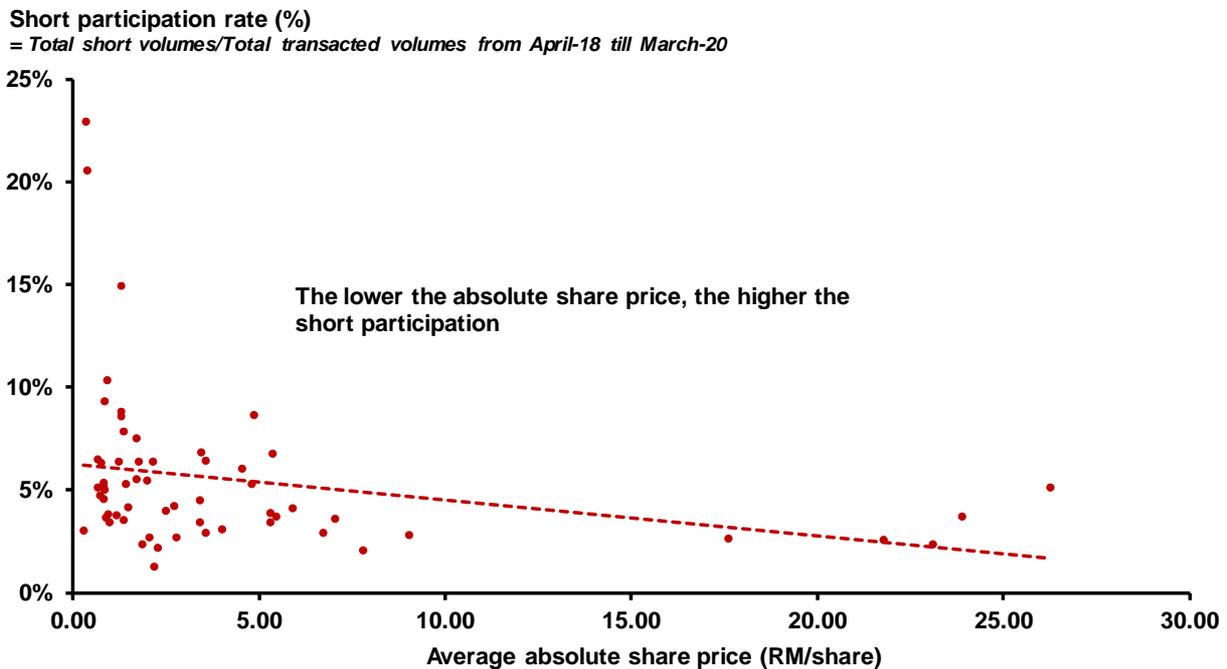
Figure 3: Higher short participation in stocks that have lower market caps



Note: we use April-18 as the start date because it was when IDSS commenced operations

Source: Bloomberg, Kenanga Research

Figure 4: Higher short participation in stocks with share price are lower in absolute terms



Note: we use April-18 as the start date because it was when IDSS commenced operations

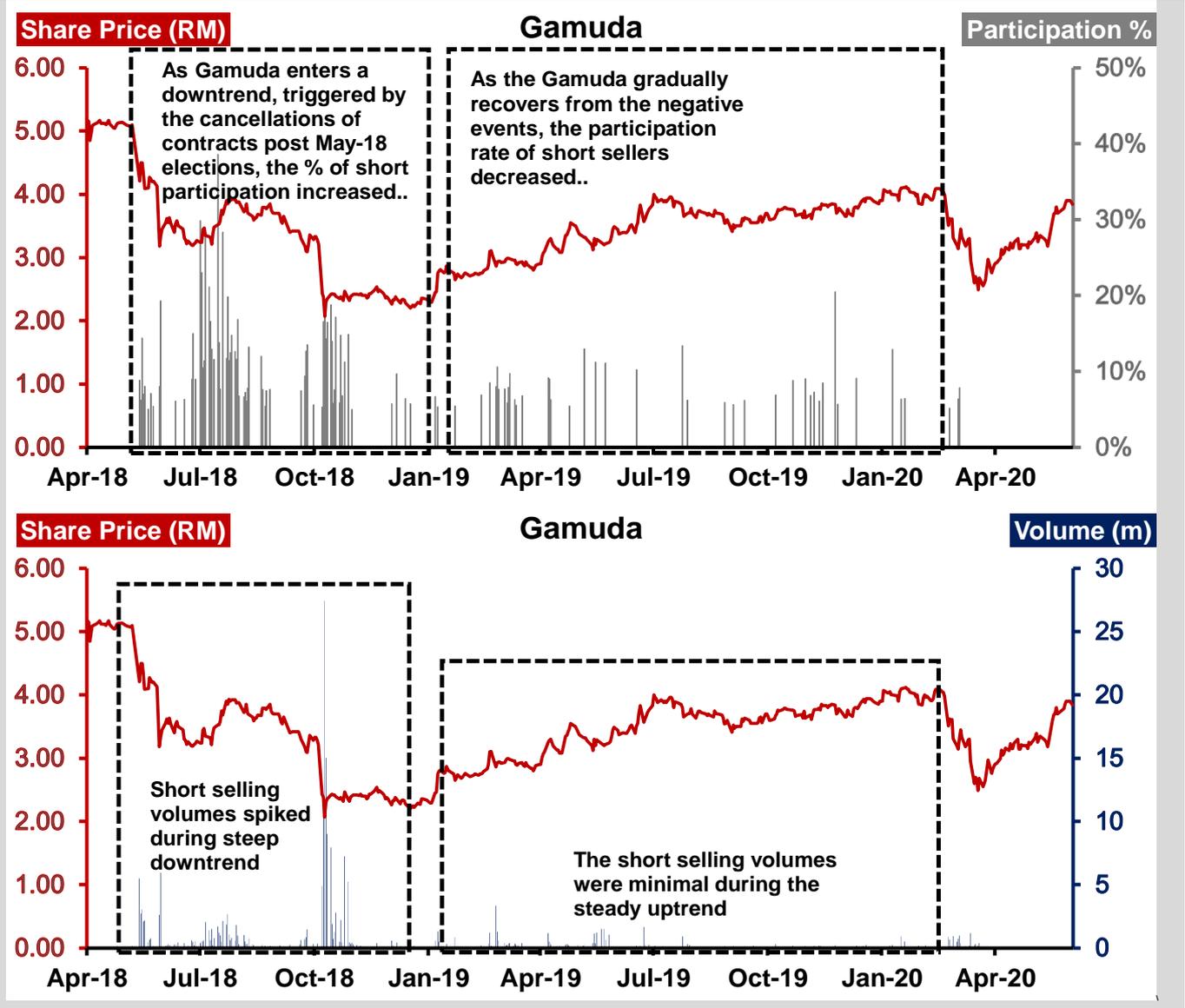
Source: Bloomberg, Kenanga Research

Our observations

Below we list down common identifiable patterns and provide examples:

Pattern #1: Short selling participation rates and volumes are higher during a downtrend compared to an uptrend – indicating short sellers’ preference to short in a down trending market. We define a down-trending stock if their stock prices are < 200-day simple moving average.

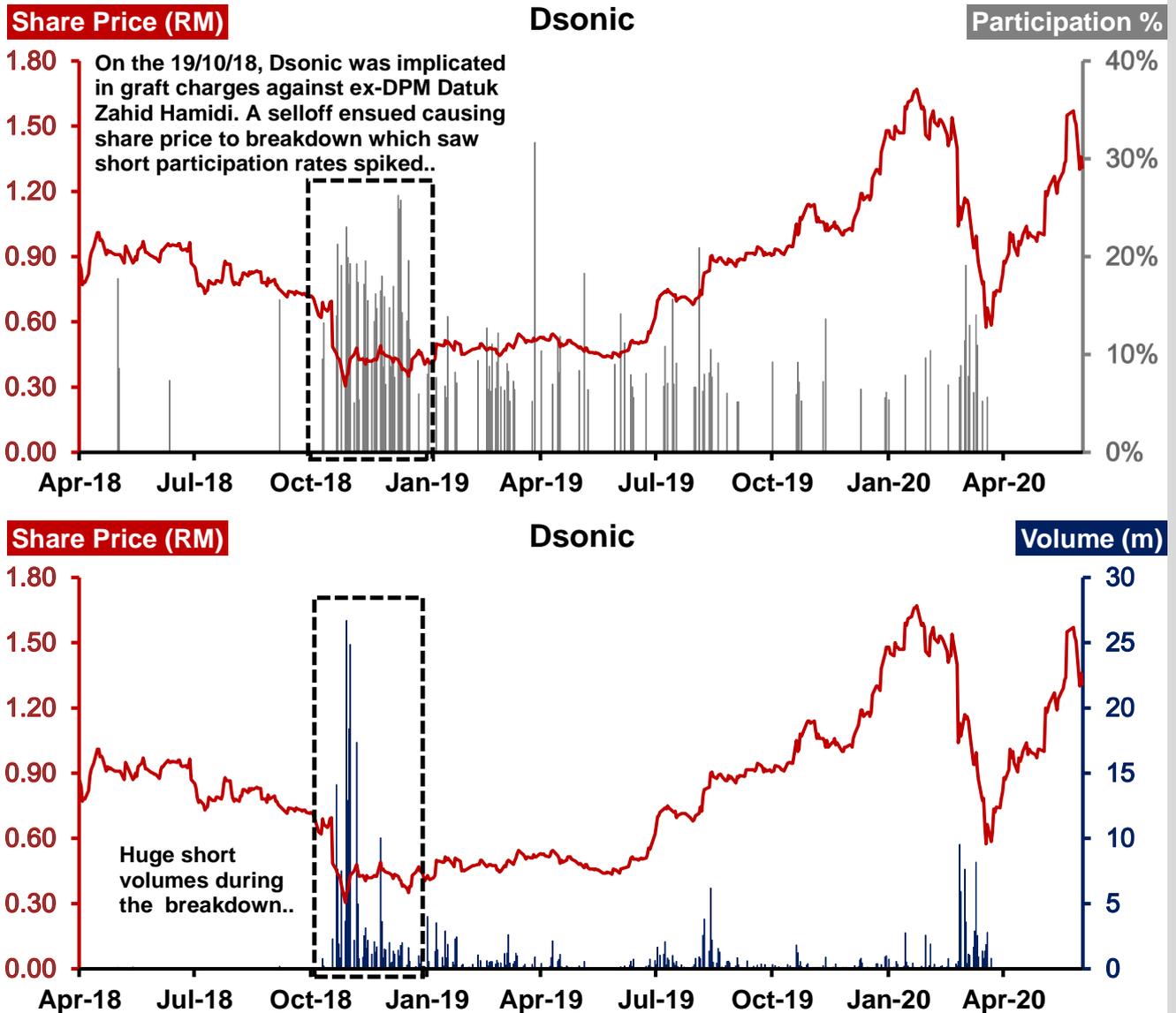
Example 1: GAMUDA
Up-trending stocks face less short volumes



Source: Bloomberg, Kenanga Research

Pattern #2: Short participation rates and volumes increase dramatically especially during breakdowns – possibly fuelling a downward momentum

Example 2: DSONIC
Short Participation rates spike during breakdowns



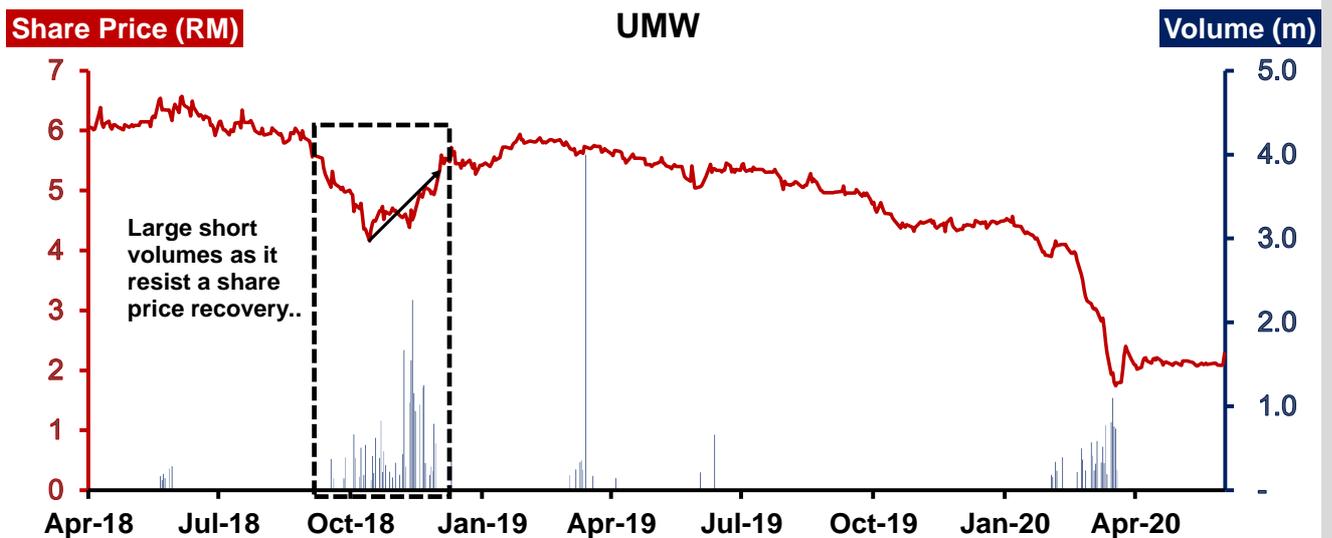
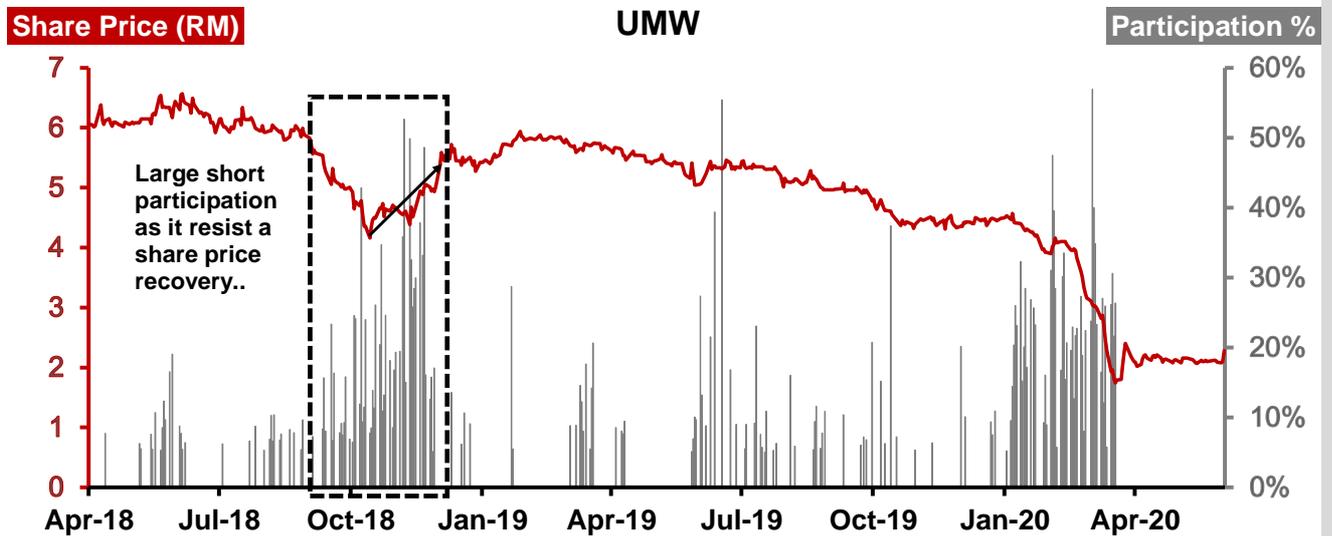
Source: Bloomberg, Kenanga Research

Dsonic fun fact: Recall on the 26th February 2020 – DSONIC implied that short sellers were the cause of its share price limit down and requested Bursa to remove them from the Approved RSS list (*reference link: <https://bit.ly/dsonicUMA>*).

In actual fact, out of the total transacted volume of 58.5m on that day, only 0.58m were attributed to short sellers i.e. only 1%! So it was absolutely inaccurate for Dsonic to fault the short sellers for triggering a sell-down and even more so causing the limit down. Nonetheless, we do note that for the subsequent weeks, short sellers' participation in the counter picked up (to a high of 19%) as they sensed weakness from the breakdown/limit down which occurred on the 26th of February.

Pattern #3: Short sellers tend to resist a share price recovery from a downtrend. The sharper the recovery i.e. V-shape recovery, the stronger the resistance.

Example 3: UMW
Short volumes increase during share price recovery from a downtrend

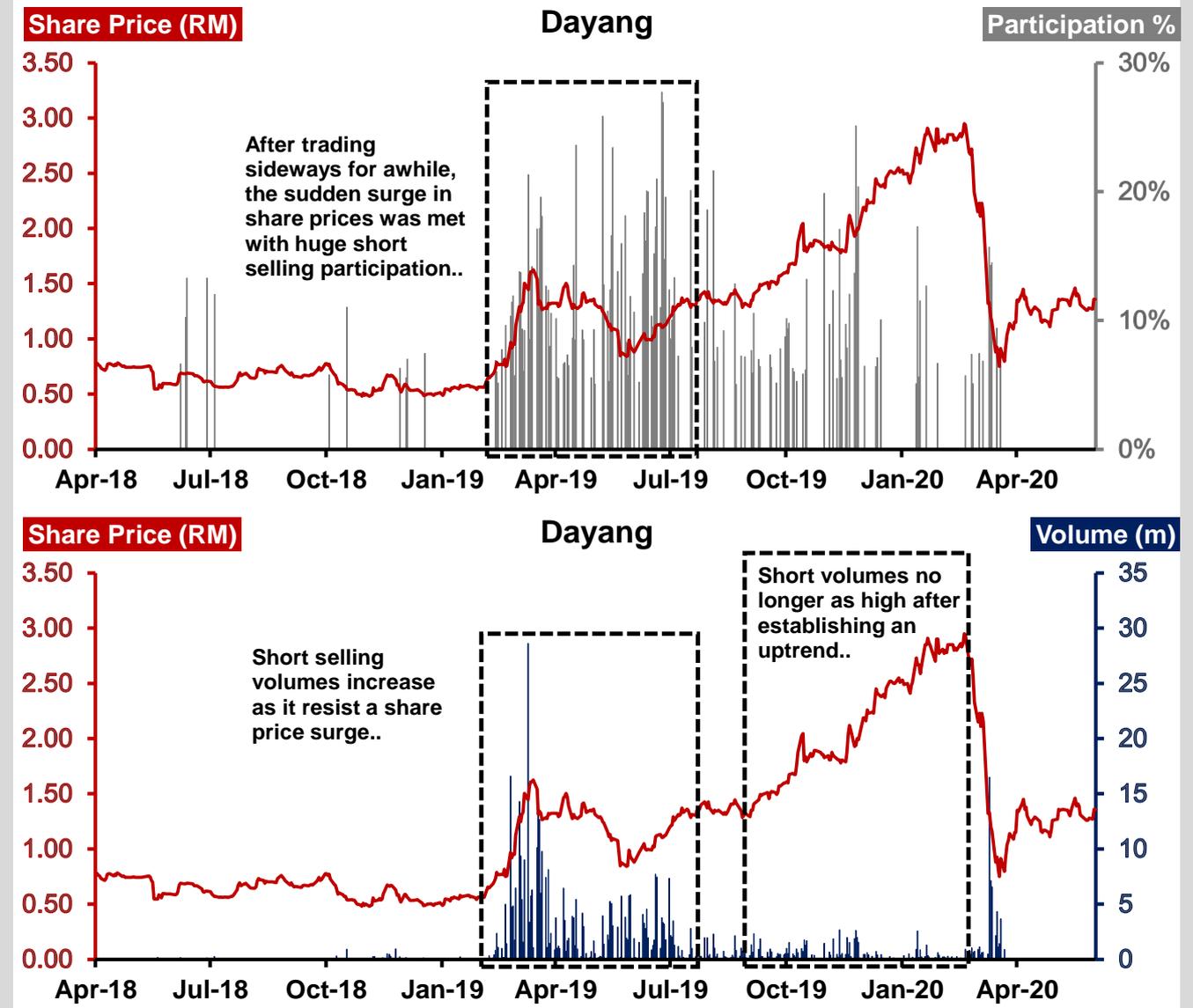


Source: Bloomberg, Kenanga Research

Pattern #4: Short sellers tend to resist a share price surge when it had consolidated sideways for some time.

Example 4: DAYANG

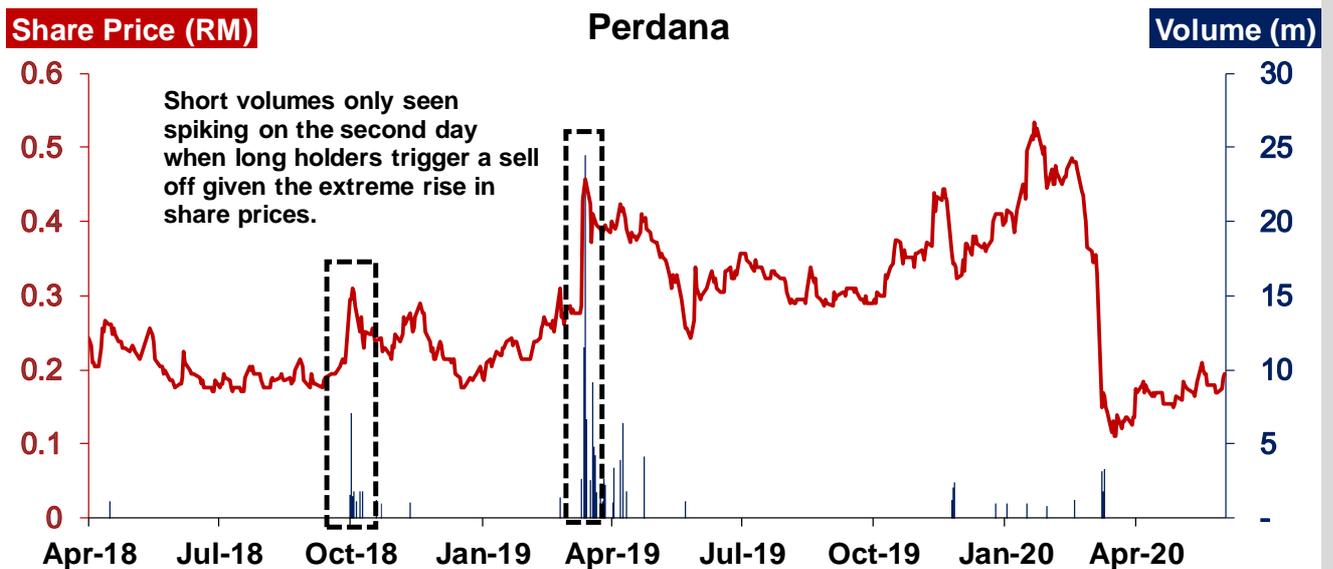
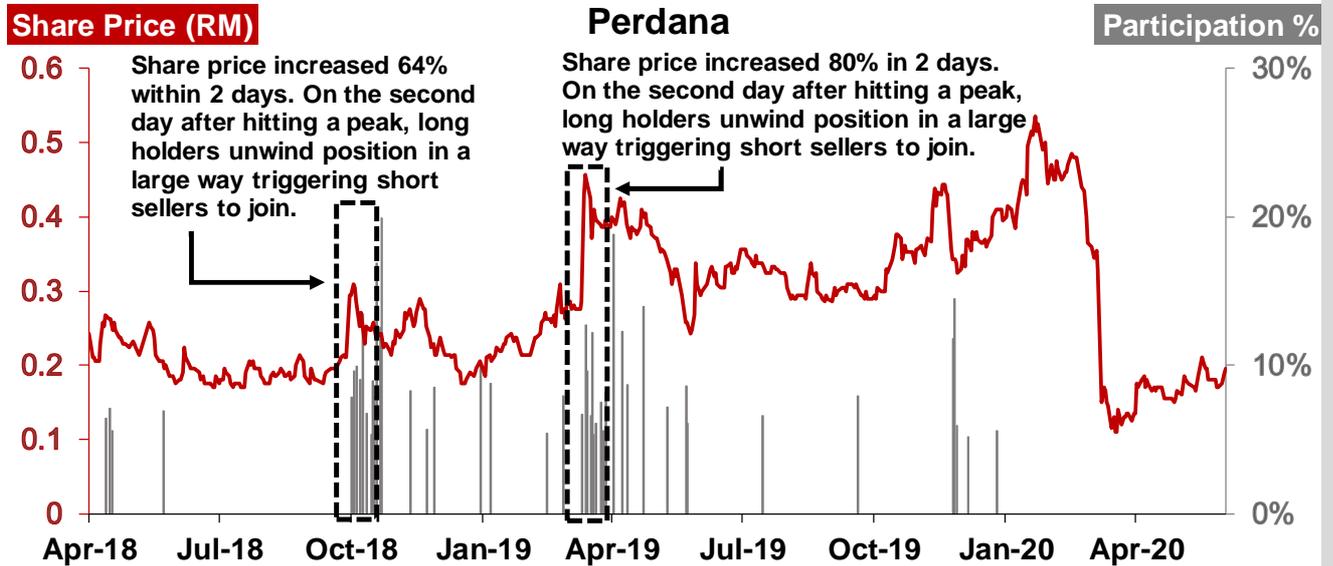
Short volumes increase as share price breakout after trading sideways for awhile



Pattern #5: Long position holders unwinding after a parabolic rise in share price will induce short sellers to participate in the selling

Example 5: Perdana

Short sellers join the selling when long holders unwind after an exponential share price rise



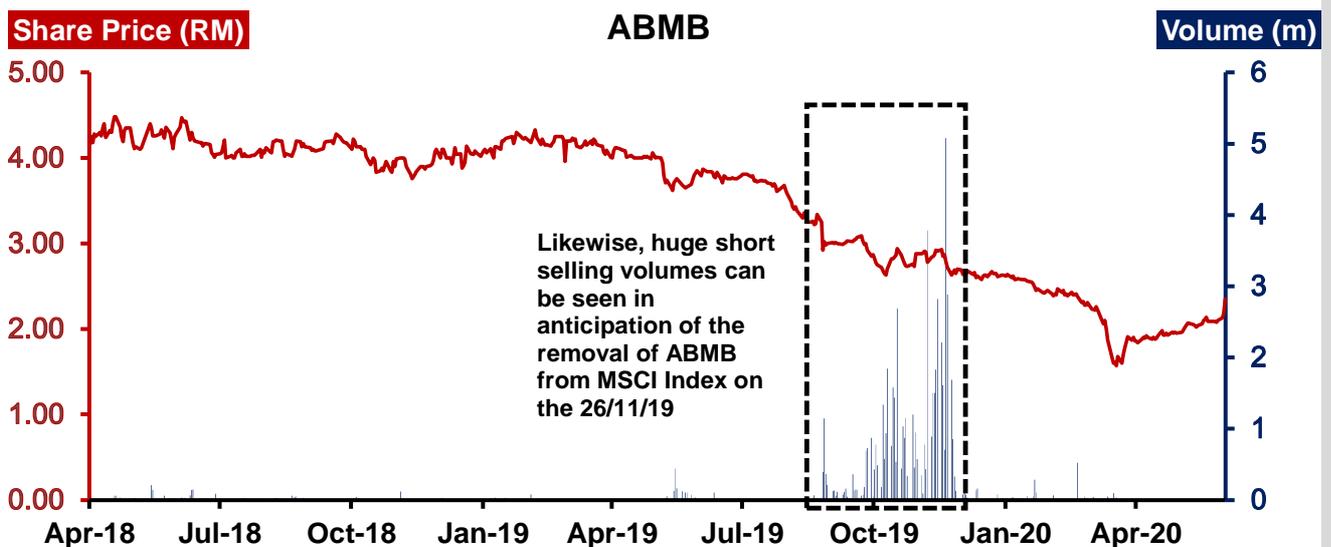
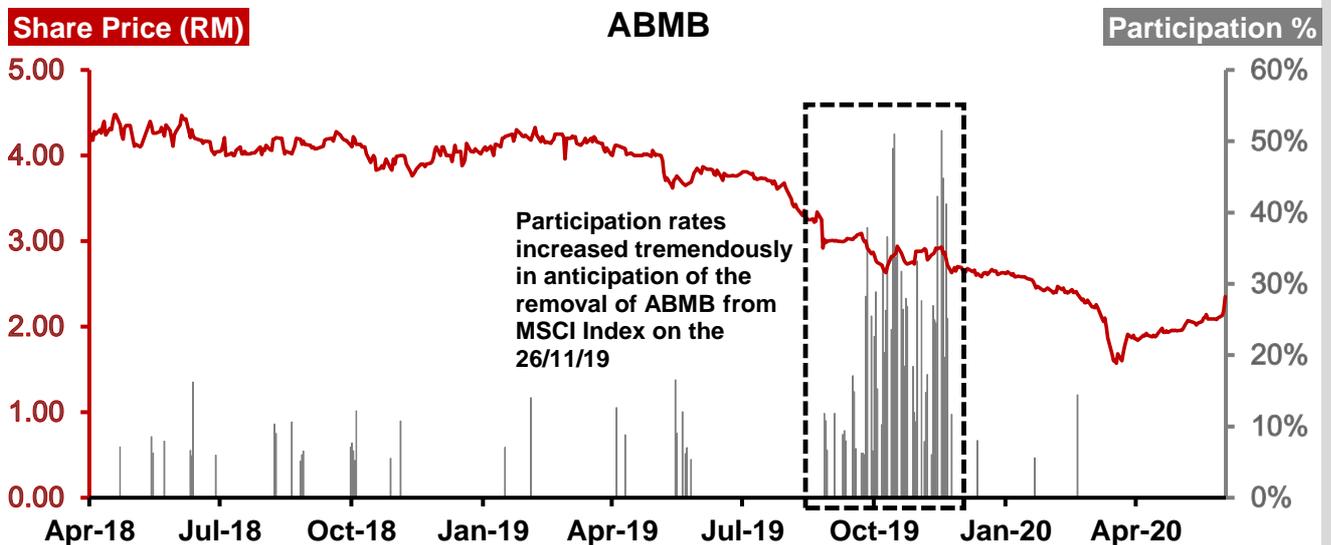
Source: Bloomberg, Kenanga Research

Pattern #6: In this pattern, we highlight that the short volumes were mostly contributed by the RSS participants (and not IDSS/DT). RSS short sellers turned aggressive (as far back as 2 months prior) towards counters getting removed from MSCI/FTSE Index.

We note that this is the only instance that RSS sellers participate in a huge way. Besides this, we note that participation rate of RSS is minimal as compared to IDSS/DT. In this scenario, we believe RSS short sellers are the ones keeping share prices subdued in anticipation of a huge sell-off by funds that track the MSCI/FTSE Index during rebalancing dates. We note that these RSS participants (dominated by foreign institutions) are therefore extremely sophisticated to be able to predict the removal of constituent stocks as far back as 2 months.

Other MSCI/FTSE removal examples such as SPSETIA (removed on 26/11/19), SIMEPROP (removed on 26/11/19), YTLPOWER (removed on 20/9/19) and IOIPG (removed on 28/5/19) also exhibit similar pattern.

Example 6: ABMB
In anticipation of MSCI removal, short volumes surge



Source: Bloomberg, Kenanga Research

In Conclusion

The majority of short sellers in our market are (i) technical/momentum-driven and (ii) downtrend bias. Therefore, it is safe to say that short sellers (with exception to RSS) will not short a stock just because stock prices are high or its fundamental valuations (e.g. PER or PBV) are overvalued. Safe to say, short sellers would never derail an uptrend trajectory. However, we caution that short sellers could amplify a sell down (through momentum) IF long position holders unwind their position in large volumes (regardless whether the stock is in downtrend or uptrend).

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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Published and printed by:

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