THE STOCK MARKET GAME™
SMG WORLDWIDE

Stock talk

Short Story

by Bill Dickneider

You may not believe the following story, but it comes from a reliable source. The events took place late at night, high in an office building near the New York Stock Exchange. It was quiet — except for a soft noise that sounded like … someone chewing on cheese.

" You borrow stock from a broker and sell it. Later, you buy stock of the same company and pay the broker back. You earn money only if the stock's price drops before you buy and repay the shares. Why? Because you keep the difference between the higher selling price and lower buying price. "

Small Talk

"Stocks can talk," said a mouse named Fritter. Fritter was sitting on a desk, munching on a morsel of Swiss cheese from someone's leftover sandwich.

"How do you know they can talk?" asked another mouse called Sockaway. Sockaway was lying on the desk with both feet propped up on a computer keyboard.

"I heard them," answered Fritter. "Last night a couple of stock certificates were in the next office, sitting on the windowsill and peering out at the lights below. They had a long discussion about someone selling them short that day. I'm not sure what they meant. Maybe someone was underestimating their smarts or something."

"Not exactly," answered Sockaway. "Let me explain what selling short means in the stock market. Remember the Mattel stock you almost bought a while ago? What if you had made the investment? How could you have earned any money?"

"It's simple," answered Fritter. "Buy low and sell high. I like toys, and Mattel looked like a good company. I had thought about buying shares and holding them for a long time. Later, I could have sold them at a higher price and earned some money. But I'm glad I didn't buy the stock because its price went down, not up."

What Comes First?

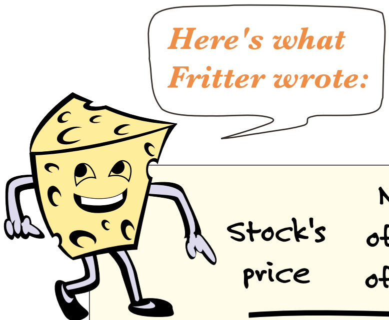
"What if you had sold the stock short?" said Sockaway. "Instead of buying low and selling high later, you could have sold high and bought low later."

"Impossible!" snapped Fritter. "How could I have sold shares of Mattel if I hadn't bought any in the first place? I can't sell what I don't own."

"But you can," answered Sockaway.

"You borrow shares of Mattel from a stockbroker and have the broker sell them for you. Later, you buy shares of Mattel and pay back the stockbroker. You would have earned money because the stock's price dropped between the time you sold them short and when you bought them to pay back the broker."

"Let's figure it out," continued Sockaway. The agile mouse then turned on the computer sitting in front of him and began dancing about on selected keys. "There, I'm on the Internet," said Sockaway, who then skipped about on more keys to navigate to a stock market site. "Here are Mattel's stock prices. Write them down on your notepad and let's see how much you would have earned by selling short 100 shares."



	Stock's price		Number of shares of Mattel		Total value
Sept. 16, 1999 Borrow and Sell	$23.04	x	100	=	+ $2,304
Feb. 16, 2000 Buy and pay back	$11.06	x	100	=	- $1,106
Difference I keep					$1,198

"Let's see," said Fritter. "If I had sold 100 shares short on September 16 of last year, I would have received $2,304. Later, I could have paid the broker back by buying 100 shares on February 16 of this year. But those shares would have cost only $1,106, so I would have kept the difference, or $1,198.

"Not bad!" squeaked Fritter. "I'm going to look for stocks that are overpriced and are about to fall. Then I'll sell them short and earn a bundle."

In Short, It's Risky

"Hold on," cautioned Sockaway. "Don't forget you'd have to pay for your broker's services. And short selling is very risky. You could end up losing your money. For example, what have stock prices generally done over the years?"

"They've gone up," answered Fritter. "So what?"

"So plenty!" answered Sockaway. "The only way you'd make money by selling short is to pick stocks that go down, not up. So you'd be bucking the stock market's upward trend. Besides, picking stocks that are overpriced and are going to drop is harder than biting into a brick of stale Parmesan cheese."

"Ouch!" remarked Fritter. "I don't want to lose my teeth – or my money."

"But suppose you sold a stock short and its price started to go up instead of down?"

"Would I keep my teeth but lose my money?" asked Fritter.

"Right," answered Sockaway. "When repaying the borrowed stock, you'd pay more to buy the stock than you got when selling it. And the higher the stock price went, the more you'd lose. I bet you'd be scared out of your whiskers."

Fritter frowned. "But if short selling is so risky, does it do *any* good in the stock market?"

"Sure," said Sockaway. "Short selling can protect you against losing money on a stock you already own. Say you had bought the shares of Mattel you told me about and wanted to keep them for a long-term investment. Then you start worrying that the stock's price might fall, so you wish you could protect your investment somehow. If you don't want to sell the stock, what could you do?

"Could I sell the stock short?" asked Fritter.

"Yes," answered Sockaway. "If its price does fall, you'd earn money on the shares you sell short. These earnings would then offset money you lose from a lower price on the shares you own."

"I like that," smiled Fritter. " Maybe I'll pick another business and buy its stock. What company makes Velveeta?"

Write Now

Pick one of the following and write a short paragraph.

Look at the calculations Fritter made on the notepad. Suppose the price of Mattel's stock had gone up to $40 instead of down to $11.06. Would Fritter have earned or lost money?

Suppose Fritter had bought 10 shares of Mattel and then sold 10 shares short to protect the investment. Would Fritter gain or lose if the stock's price goes up? Explain.

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