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What is short selling?

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WHAT DOES IT MEAN?

The term "short selling" is often used to refer to the sale of shares that the seller does not own at the time of the sale.

Traders who engage in such activities expect the price of the targeted shares to fall. They short sell with the hope that they can buy back the shares subsequently at a lower price, thereby profiting from the difference in the selling and buying prices.

This differs from the conventional way of making profits from share trading by buying shares first and selling them later at a higher price.

Short selling is allowed if the shares are bought back later on the same day, and this will be treated as a contra trade.

This differs from conventional contra trading where the purchase takes place first and is done within a three-day trading period.

WHY IS IT IMPORTANT?

Short selling is allowed in Singapore as it allows more efficient price formation, increases market liquidity and facilitates risk.

However, when there is much market uncertainty, short selling can result in increased market volatility. Short selling may also be manipulated by unscrupulous traders, particularly where it involves the creation of false rumours to induce others to sell.

In Singapore, the Central Depository (CDP) mitigates the potentially disruptive effects of short selling on the settlement system by buying back shares on behalf of sellers who do not possess the shares for delivery on settlement day.

When the CDP does this, the cost of purchase and an additional penalty is charged to the seller who failed to deliver the shares.

Hence, short selling carries considerable risk, no different from contra trading.

If you want to use the term, just say: "It is better to borrow the shares that you do not own if you plan to short sell."

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