Short selling Chinese stocks getting tougher

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Shorting US-listed Chinese stocks was a popular theme among global hedge funds last year thanks to questionable accounting practices. Sino Forest, the Toronto-listed Chinese forestry company targeted by Carson Block's Muddy Waters, saw its stock get hammered and has subsequently filed for bankruptcy protection, although it resolutely denies any financial wrongdoing and has subsequently filed a lawsuit against Block to the tune of USD4billion. But as the *Financial Times* reported this week, the fact that so many of these US-listed companies have already seen their share prices evaporate means that finding suitable targets is getting increasingly harder for traders, with dozens having now been delisted. The Bloomberg China Reverse Merger index has dropped 68 per cent since its 2010 peak: the index tracks 82 New York-listed Chinese companies.

The response, it seems, is that short sellers are turning their attention to Hong Kong-listed Chinese stocks. DataExplorers would appear to confirm this shift by showing that average short interest in such shares has increased from 1.3 per cent of shares outstanding to 1.6 per cent, whilst US-listed stocks have seen average short interest fall from 2.8 per cent to 1.8 per cent. Block believes traders will attack more Hong Kong-listed companies in the coming months, again as a result of potentially fraudulent activity. The challenge though is that the most extreme frauds have probably already been unearthed and "their share prices have been punished" Block was quoted as saying. "You'll see them trading at p/e ratios of less than three."

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