

## Force Protection – A textbook short squeeze in action?

By Matt Blackman

*This is a clear example of how shorts, both legal and naked can decimate the value of a stock. It is also an example of the explosive short squeeze rally a heavily shorted stock can experience when positive news is combined with compelling technicals.*

If you haven't had a chance to watch the Bloomberg special entitled *Phantom Shares*, I highly recommend it. You can view the 25 minute special at <http://tinyurl.com/yrbm3> that casts a revealing spotlight on a questionable practice on Wall Street that for years has allowed a few well-heeled players to short stock without having to first borrow it. While this is neither the time nor place to argue its morality, suffice it to say that naked shorting has been responsible for putting more than a few public companies out of business and costs investors billions per day in losses according to Bloomberg.



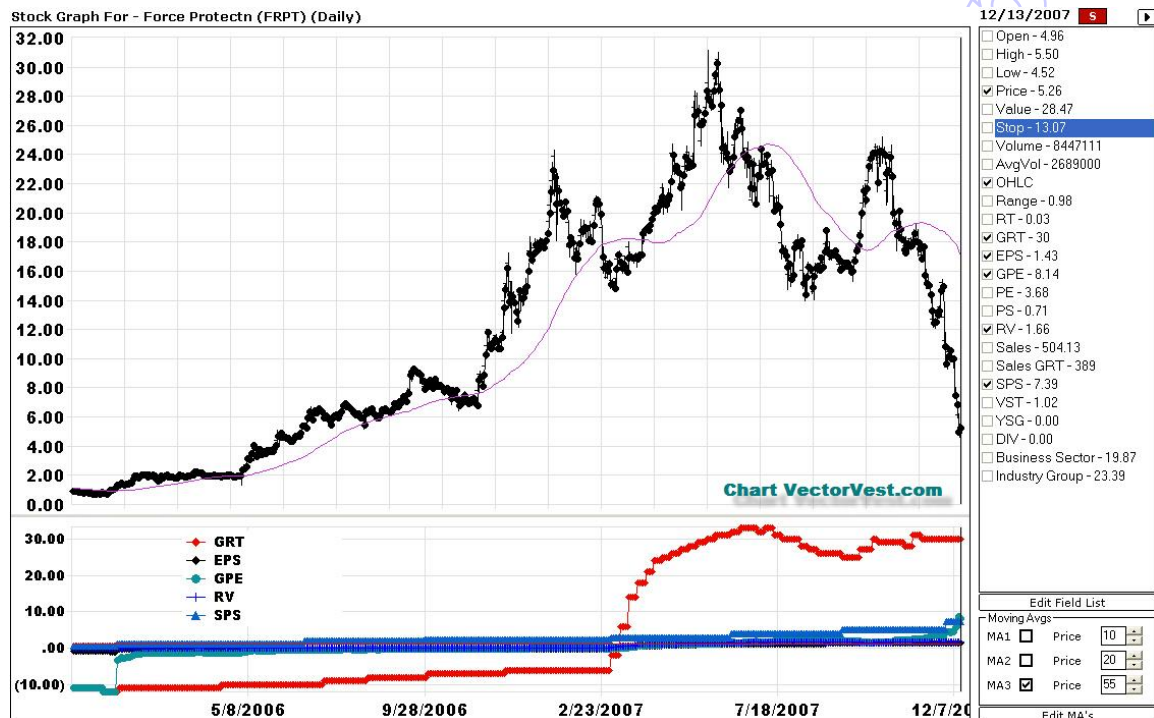
Figure 1 – Intraday chart of FRPT showing the bearish head & shoulders top pattern with and drop of stock to long-term support at \$5.00. Note the volume capitulation that started to build at the beginning of December and then huge move as the stock rallied from \$4.99 December 12 to over \$7.00 intraday December 14, a 40% move! Chart OmniTrader.com. SqueezeTrigger courtesy [www.Buyins.net](http://www.Buyins.net)

After much lobbying, the Securities and Exchange Commission enacted legislation in an attempt to curtail naked shorting called RegSHO (Regulation Short-Sales) in January 2005 which requires that shares sold short that do not have corresponding proof of share ownership within 13-days of being shorted, are listed as FTD or failed-to-deliver and added to the RegSHO threshold list. This is supposed to mandate that these shares be delivered but one only has to look at a stock like Overstock.com (OSTK) that has been on this list with shares that have FTD for more than 600 days to see that somehow the naked shorts have found a way to avoid this costly requirement. According to a news release issued by Buyins.net on December 14, 2007 Force Protection (FRPT) is just another of more than 175 naked short victims with undelivered shares outstanding – it has been on the RegSHO threshold list for 122 consecutive days and counting.

A glance at figure 1 shows how the stock has been decimated since May 2007 dropping from \$31 to \$4.99 on December 12. According to Buyins.net, short interest as a percent

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of the FRPT float is a whopping 31% and it is well below both its long-term SqueezeTrigger of \$19.81 (volume weighted average price at which shorts sold the stock over the long haul) and the most recently monthly SqueezeTrigger price of \$15.55. A bearish head & shoulders top pattern formed on the stock over the last 12 months may have been one reason why the stock had been shorted so enthusiastically. But when a heavily shorted stock rallies, shorts watch their profits shrink and then turn to losses as a short squeeze begins to build. As we see from in the last two candles in figure 1, this looks to be exactly what happened and with SqueezeTriggers at \$15.55 and \$19.81, shorts have a lot of pain ahead if this stock continues to rally. Another bullish contributor is the corporate fundamentals that on this stock are anything but bearish, helping to set the stage for what came next.



Then on December 14, the company issued a news release to dispel rumors that were circulating about company difficulties, rumors FRPT claims are false. That combined with the company's strong fundamental position set the stage for an explosive short squeeze rally driving the stock up more than 35% in just a few hours.

Shorts borrow a stock and sell it in the hopes that the price will drop so they can buy it back and keep the difference as profit. But naked shorting allows a few specially-privileged institutions and pro traders to sell a stock without ever having to borrow it and this is a revealing case of this detrimental practice in action. Much like the counterfeiter produces fake currency, the effect is the same and the few profit at the expense of the many.

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Anticipating the reversal of a stock in freefall can be a dangerous practice aptly named 'trying to catch a falling knife.' But unless this stock suffers a devastating corporate meltdown and goes out of business, even the biggest shorts at some point will have to deliver stock certificates which means buying the stock back and this can have explosive ramifications. In the event that FRPT continues to come through with stellar profits and earnings (as current earnings forecasts suggest they will), buyers could continue to pile in which would see this short squeeze accelerate as shorts are panicked into the mass buying spree. As we saw recently, it has the potential to provide those who correctly anticipate this situation and buy the stock with a very wild and profitable balloon ride.

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Matt Blackman is the host of [www.TradeSystemGuru.com](http://www.TradeSystemGuru.com), a website devoted to discovering and better utilizing trading tools, techniques and cutting-edge market data, combining technical and fundamental approaches and to reduce emotion through the use of pre-defined rules to make better informed market decisions. Matt also writes a free weekly stock market report. Email: [matt@tradesystemguru.com](mailto:matt@tradesystemguru.com)