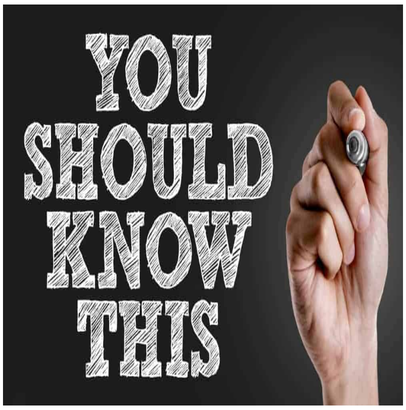

Why Warren Buffett Doesn’t Short Stocks

Description

Last week, we saw **Gamestop** short sellers run away with their tails between their legs, after being forced to cover their positions. The stock saw a massive short squeeze caused by Reddit users pumping the stock–initially because they thought it was undervalued, later to prove an ideological point.

A great many Wall Street firms lost money over GameStop. Melvin Capital and Citron are the two most cited names, and there are others. But one famous investor didn’t lose a penny from all that happened with GME:

Warren Buffett.

An “all long” investor, Buffett hasn’t shorted stocks in years. He used to–not to generate enormous profits, but to hedge his long positions. But he gave up the practice decades ago. In this article, I’ll explore why Buffett gave up shorting, and what he does now instead.

A bad company can be promoted indefinitely in the stock market

The main reason Buffett doesn’t short is because “worthless” stocks can be artificially promoted for long periods of time. If you get enough excitement going around a stock, its value will go up, even if nothing about the business itself changes. And in fact, such promotions can genuinely make the business worth more. If a company issues equity during a dramatic stock price spike, it will get cash that gives it some intrinsic value. So saying that a stock should go to zero because its business isn’t worth anything today is never quite right. You never know when a stock promotion will lead to a massive cash windfall for a company.

What to do instead

While Buffett has given up shorting stocks, he hasn’t given up trying to profit from bear markets. He still aims to make money in bulls as well as bears. The only thing that has changed is his strategy. Whereas in the past, Buffett would short stocks, today he just tries to buy undervalued companies on the dip. With a little patience, this strategy allows you to profit from bear markets without having to short anything.

Consider Buffett's **Suncor Energy Inc** (TSX:SU)(NYSE:SU) investment, for example. In 2018, he bought the stock while it was in the $40-$50 range. Later, in the COVID-19 market crash, he saw his holdings decline to less than $20.

Did he sell the stock?

No. He just bought more.

Although Suncor lost a lot of money in 2020, its business has the fundamentals needed to bounce back when the pandemic is over. Its losses were mainly due to lower oil prices and less gasoline sales–these conditions aren't permanent.

Buffett, seeing this situation, simply doubled down on his position, buying *more* Suncor stock at $20. As a result, he lowered the *adjusted cost base* for his total position, and has more upside on it going forward.

Does this guarantee that Buffett will ever profit on his earlier SU buys, at prices above $40? No. But it does increase his chances of profiting on Suncor overall.

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