Beat: Business

Muddy Waters market manipulation strategy under investigation

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USPA NEWS - After 4 years of successful short-selling, American “activist fund” Muddy Waters is falling under legal scrutiny, for its borderline investment strategies. CEO Carson Block argues he is simply investing and talking about it, whereas stock market authorities suspect foul play. Is the sun vanishing on the investment firm’s raging tactics?

A classic short-selling tactic, tied to intense lobbying

Short-selling was not invented by Muddy Waters. The business practice has long existed, in which an investment firm will bet on a company’s stock price falling, rather than rising, as is usually done. The tactic emerged in the 17th century, in the Netherlands. Going back to the origins of the investment method, historian David Kestenbaum says: “Then, as today, shorting was perfectly legal. Economists says it's even a healthy thing to have in a market, but what Le Maire did next would be considered unethical today, and it was 400 years ago. He lied. Le Maire started spreading rumors, things that would drive the stock price down”. Carson Block’s trick was to add a thick political layer of carpet-bombing communication, instead of merely hoping that the pre-purchase analysis was correct. In a nutshell, Carson Block makes the demise of his targets happen, instead of waiting for it to.

Once the short-selling position is taken, Muddy Waters will issue vast amounts of lobbying material, via numerous platforms (namely Business Insider) and cast a worrying light on the target’s financial health. Whether it be due to what Block names “prescient analysis” or to an artificial panic set off on the markets, his bets always win. Once the fire has started and other investors start selling their shares, Carson Block closes the short position and pockets the money. In 2011, Carson Block was able to drain fund manager John Paulson of 100 million euros in a single short.

Many are the victims

The number of successful raids by Muddy Waters is reaching a sizable tally. Initially focused on China, due do Carson Block’s extensive experience in that country, the range has considerably expanded, namely into western Europe, and even a few domestic US-based targets. In the past few years, Muddy Waters has shorted (and sometimes destroyed) Sino-Forest, NQ mobile, Noble Group, Focus Media, Olam International, Orient Paper, China Media Express and Rino International. And that’s only Asia. Since then, the hunting grounds have expanded to Europe, where German media firm Ströer fell victim to Muddy Waters short-selling attacks. In 2015, it launched a new attack on a Swedish telecoms group, as reported by financial analyst Daniel Thomas: “The activist investor on Thursday declared a short position in the company’s stock, alleging it could have made “corrupt payments” in parts of its Eurasian and Nepalese operations that exceed SKr17bn.” Lately, Muddy Waters has been busy attacking French distribution Rallye-Casino, using the same techniques. But it seems many financial market authorities have had it with the investment fund and the party may be coming to an end.

The heat is on

Nine years have sufficed for Muddy Waters to catch the eye of regulatory bodies and financial law enforcement agencies, both for technical irregularities in its management, and for the overall business practices of the hedge fund. Carson Block shields his investment fund behind an image of “activism”, which often gives governmental authorities cold feet when it comes to prosecution, but market authorities aren’t buying it: to them, it seems to be outright market manipulation. The law is very clear, on both sides of the Atlantic, as it is in China: just as insider trading is prohibited (for its unfair nature), manipulating stock prices in order to artificially influence the fate of an investment vehicle is illegal. For the countries in which the targets are based, it is simple, greedy and gratuitous destruction of value, and they’re not having it.

Both the German and the French Financial Market Authorities (FFMA and AMF) have launched investigations, after having spotted the pattern: Muddy Waters invests, then slanders, then divests, leaving nothing but ash and rubble behind it. Financial analyst Katia Wachtel writes: “After a Muddy Waters' report, Orient Paper fell 50%. After a Muddy Waters' report, RINO International fell 60%. China MediaExpress fell 28%, then had to be halted, then the CFO of the company resigned, and then the company was delisted altogether. Duoyuan Global Water fell 40%, and the CFO resigned.” Similar initiatives are likely to emerge, coming from China (where many companies have fallen to Muddy Waters’ tactics), in coming years.

To some extent, Muddy Waters has been skillful in its market operation, over the past few years. While its scorched-earth policy seemed unsavory and unethical to many, the activist fund managed to stave off retaliation through loopholes, thus achieving the double and highly-profitable role of investor and influencer. But has Carson Block become too greedy? Legal investigations have only just been launched, but it's only a matter of time before sovereign governments take action against the firm which they consider to be metastasizing their businesses.

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Editorial program service of General News Agency:
United Press Association, Inc.
3651 Lindell Road, Suite D168
Las Vegas, NV 89103, USA
(702) 943.0321 Local
(702) 943.0233 Facsimile
info@unitedpressassociation.org
info@gna24.com
www.gna24.com