TRADING EDUCATION SERIES

Short Selling: From Basics to Advanced

BEGINNER | INTERMEDIATE | ADVANCED | PSYCHOLOGY

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Educational content only. Not financial advice.

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How To Use This Guide

Work through it in order. Master the mechanics before the setups, and the setups before the size. On the short side, **survival comes first, profits second**. Every section ends with sources so you can verify the rules yourself.

CORE PRINCIPLE

Your edge isn't predicting tops. It's managing risk when you're wrong and staying disciplined when you're right.

LEVEL 01 // BEGINNER

The Foundations

What Is Short Selling?

Shorting is selling shares you don't own, betting the price will fall. You borrow shares through your broker, sell them now, and later **buy to cover** to return them. Profit = sell price − cover price (minus fees and borrow costs).

EXAMPLE
Short 100 shares at $10.00 → cover at $8.50 = **+$150**. Cover at $12.00 instead = **−$200**.

Borrowing & Locates

Under **Reg SHO Rule 203(b)**, before accepting a short sale a broker must have reasonable grounds to believe the shares can be borrowed and delivered on settlement — this is the **locate**. Selling short without a locate ("naked shorting") is restricted. Your broker may have shares on its easy-to-borrow list, or you may need to request a locate (sometimes for a fee).

Margin Requirements

- Shorting requires a **margin account**.
- **Reg T initial requirement:** 150% of the short sale value (the 100% proceeds plus 50% additional margin).
- **FINRA Rule 4210 maintenance:** for stocks ≥ $5, the greater of $5/share or 30% of market value; under $5, the greater of $2.50/share or 100%. Brokers can — and often do — require more ("house" requirements).
- If equity falls below maintenance, expect a **margin call** or forced buy-in.

⚠ UNLIMITED LOSS RISK
A long position can only fall to $0. A short position has **no ceiling** — a stock can go up 100%, 300%, 1,000%. Your maximum gain is capped (price → $0); your maximum loss is theoretically unlimited. This asymmetry is why risk control is everything on the short side.

Sources: SEC Reg SHO (17 CFR 242.203); Federal Reserve Reg T; FINRA Rule 4210; SEC Investor.gov "Short Sales".

LEVEL 02 // INTERMEDIATE

Rules of the Road

SSR — Reg SHO Rule 201 (Alternative Uptick Rule)

- **Trigger:** a stock drops **10% or more from the prior day's close**.
- **Effect:** short sales can only be executed/displayed **above the current national best bid** — no hitting the bid.
- **Duration:** rest of the trigger day **plus the entire next trading day**. A fresh 10% drop while on SSR re-triggers it.

Practical impact: on SSR you must short on upticks/the offer. Liquidity for shorts thins, fills get harder, and squeezes can be sharper because shorts can't pile on the bid.

HTB vs ETB & Borrow Fees

	ETB (Easy to Borrow)	HTB (Hard to Borrow)
Availability	Ample supply	Limited / may need locate
Cost	Low or no fee	Annualized fees can be very high
Risk	Lower recall risk	Shares can be recalled; buy-ins

Borrow fees are typically quoted as an annual rate and charged daily on the position value. High fees mean the crowd is already short — a squeeze warning sign.

Core Short Setups

FAILED BREAKOUT
Price pushes through a key level (HOD, premarket high) and can't hold. Trapped longs become sellers. Entry on the reclaim failure; stop above the failed high.

PARABOLIC FADE
Multiple extended green candles, volume climax, and the first real red candle / lower high. Don't short the strength — short the **first sign of exhaustion**. Stop above the blow-off high.

VWAP REJECTION
Stock below VWAP rallies into it and gets rejected. VWAP acts as resistance; entry on rejection, stop just above VWAP / the rejection wick.

Sources: SEC Rule 201 FAQs; SEC Press Release 2010-26; 17 CFR 242.201.

LEVEL 02 // INTERMEDIATE

Setup Playbook

Setup	Trigger	Stop	Targets
Failed Breakout	Break of HOD/PMH fails, price back under level on volume	Above failed high	VWAP, prior consolidation
Parabolic Fade	First lower high after volume climax / first red 5-min candle	Above blow-off high	9 EMA, VWAP, gap fill
VWAP Rejection	Rally into VWAP rejected, lower high forms	Above VWAP / wick	Low of day, support

Confirmation Signals

- Volume drying up on pushes higher, expanding on drops
- Large offers (sellers) stacking on Level 2 and holding
- Lower highs on the 1- and 5-minute charts
- Stock losing key intraday levels and failing to reclaim

Red Flags — Don't Short

- Fresh catalyst with sustained buying and no lower high
- HTB with very high fees and heavy short interest (crowded)
- Tiny float making new highs with no rejection
- On SSR and you can't get fills on the offer
- You're shorting because "it's up too much"

Timing Notes

The open (9:30–10:30 ET) has the most volatility and the widest LULD bands. Many fades set up after the first push fails. Midday chop punishes overtrading. Late-day squeezes into the close are common on heavily shorted names.

LEVEL 03 // ADVANCED

Advanced Mechanics

Low-Float Squeeze Risk

Low float + high short interest + HTB + news = squeeze fuel. Small supply means a wave of buying (including shorts covering) can move price violently. Size down hard on low floats, never add to losers, and respect hard stops.

Dilution & Offering Plays

Companies that need cash may sell shares via offerings, ATMs, or warrants. Check SEC EDGAR for **S-1, S-3 shelf, 424B prospectus** and 8-K filings. An offering priced below market often caps rallies — but pumps ahead of an offering can still rip first. Patience over prediction.

Halts & LULD Bands

The **Limit Up–Limit Down** plan sets price bands around a reference price (average of the prior 5 minutes of trades). If the market sits at a band in a limit state and doesn't exit within **15 seconds**, the listing exchange declares a **5-minute trading pause** (can be extended).

Reference Price	Band (Tier 1)	Band (Tier 2)
Above $3.00	5%	10%
$0.75 – $3.00	20%	20%
Below $0.75	Lesser of $0.15 or 75%	

Bands double during the open (9:30–9:45 ET) and near the close (3:35–4:00 ET). **Halt risk for shorts:** a limit-up halt can reopen far above your stop — stops don't protect you through a halt.

Sources: FINRA Regulatory Notice 13-12; LULD NMS Plan (Amendment 10).

LEVEL 03 // ADVANCED

Risk & Mindset

Position Sizing

FORMULA

Shares = Max $ Risk ÷ (Stop Price − Entry Price)

Risking $100, short at $5.00, stop $5.25 → 100 ÷ 0.25 = **400 shares**.

- Risk a fixed small % of account per trade.
- Set a daily max loss — hit it, you're done.
- Account for slippage and halt gaps on small caps.

Scaling In & Out

- **Scale in** only with a plan — starter, then add on confirmation, total risk defined up front. Never average up into a loser out of hope.
- **Scale out** into flushes: cover partials at targets (VWAP, prior support), trail the rest.

The Psychology of Shorting

THE MENTAL GAME

- **Ego is the enemy.** "It's too high" is not a thesis. Stocks can stay irrational longer than you can stay solvent.
- **Fear of the squeeze** causes hesitation; **revenge shorting** causes blowups. Both come from not trusting your plan.
- **Wait for the crack.** Shorting strength is gambling; shorting weakness is trading.
- **Accept the stop.** A small loss is a business expense. Moving a stop on a short is how accounts die.
- **Journal emotions,** not just P&L. Patterns in your feelings predict patterns in your losses.

LEVEL 03 // PSYCHOLOGY

Mind of a Short Seller

Why Shorting Is Mentally Harder

You're trading against the crowd, against momentum, and against a payoff where losses can grow faster than gains. Stocks tend to fall faster than they rise, but squeezes are fast too. Your nervous system has to stay calm when the chart is screaming.

The 5 Traps

1. BEING RIGHT VS. MAKING MONEY
The thesis can be correct and the timing wrong. Get paid for timing, not opinions.

2. REVENGE SHORTING
Stopped out, then re-shorting bigger out of anger. Rule: after a stop, step away for at least 15 minutes.

3. HOLDING AND HOPING
Removing a stop "because it has to come down." That one trade can erase months of gains.

4. FOMO ON THE FLUSH
Chasing a short after it has already dropped means terrible risk/reward. Wait for the next lower high.

5. CUTTING WINNERS EARLY
Fear of a bounce makes you cover too soon. Cover in pieces and let a runner work.

Daily Mental Routine

- **Pre-market:** rate your mood and sleep from 1–10. If it's below 6, cut your size in half.
- **During:** say each stop out loud before you enter.
- **Post-market:** journal one emotion, one mistake, one win.

TOOLS // CHECKLIST

Pre-Trade Checklist

✓	Before Every Short
☐	Shares located / ETB confirmed; borrow fee known
☐	SSR status checked (down 10%+ today or yesterday?)
☐	Float, short interest, and recent filings (S-1/S-3/424B) reviewed
☐	Setup identified: failed breakout / parabolic fade / VWAP rejection
☐	Entry, stop, and targets written down
☐	Size = Max Risk ÷ (Stop − Entry); halt gap risk considered
☐	Reward:risk ≥ 2:1
☐	Daily max loss not hit; emotional state OK
☐	Plan if halted: what I'll do on reopen

Trade Journal Template

Ticker: _____ Setup: _____ Date: _____

Entry: _____ Stop: _____ Target: _____ Size: _____

Result (R): _____ Followed plan? Y / N

Emotion before / during / after: _____

Lesson: _____

Glossary

Term	Meaning
Buy to Cover	Buying shares to close a short position
Locate	Broker's reasonable belief that shares can be borrowed (Reg SHO 203(b))
ETB / HTB	Easy-to-borrow / hard-to-borrow shares
SSR	Short sale restriction under Rule 201; shorts only above the national best bid
Short Interest	Shares sold short and not yet covered
Float	Shares available for public trading
Short Squeeze	A rapid rise fueled by shorts forced to cover
Buy-in	Forced cover by broker (recall or margin deficiency)
LULD	Limit Up–Limit Down price bands and trading pauses
VWAP	Volume-weighted average price
ATM Offering	At-the-market share sales by the company over time
R	A unit of initial risk per trade

DISCLAIMER

This guide is for **educational purposes only** and is **not financial advice**. Short selling involves substantial risk, including losses exceeding your initial investment. Rules and broker requirements can change; verify with SEC, FINRA, and your broker. Past performance does not guarantee future results. Do your own research and consult a licensed professional.