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## *Novastar's Collective Hallucination and The Wall Street Journal's Loss.*

Last week The Wall Street Journal published an article about the sharp drop in NovaStar Financial Inc.'s (NYSE: NFI) stock price. The article was concerned with the reaction. It couldn't reconcile the surprising severity of the stock's decline with all the publicly available information about the condition of the company and its sub-prime lending market. The article explanation was simply that investors had believed all the bad news was priced into the stock.

Below is a link to an article titled "High-Risk Lending is...well...risky" that is better informed and may be more insightful and helpful.

The article points out that NFI's stock was a hard borrow and that retail investors were holding the stock and lending it out to short sellers at 8% per year. The article provides a link to NFI stock fan's blog who writes in closing the blog of being "quite annoyed that I participated in NFI's collective hallucination."

Here is an example of the high cost of the stock borrowing rule. NFI's decline from its \$70 perch took almost 3 years to reach \$9. Its stock's 50% decline of last week shows its cost of capital was too low for too long. This allowed it to fund its uneconomic lending practices and compensate its managers longer than was optimal for the markets. Can one reasonably argue that without down-tick or borrowing restrictions NFI's stock would have reached single digits sooner and less dramatically? And if so, wouldn't it be have been better for all involved?

[Click here](http://www.asensio.com/data/press/281.pdf) to read the article.