

Weekly Market Summary

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Financial Markets 101: The GameStop Saga & Free Markets' Delusion!

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They say history occurs first as a tragedy, then as farce (a famous Karl Max quote). Maybe we're in the midst of witnessing that in US financial markets!

GameStop is an American high street shop that sells games, consoles and other electronic gadgets. In that sense, it is not anything new and exciting and it most likely was not doing too well because of the pandemic lately.

If you are not on Reddit, the latter is a social media site, kind of like Twitter or Facebook (much smaller scale though). Individuals join forums about particular topics they are interested in (football forums, art, history, love ... you name it). The one that is important for this weekly write-up is called "*WallStreetBets*". More than four million people are in it, usually discussing stocks and shares and where they are going to invest their money.

And when the Reddit's community banded together to punish Wall Street investors who had bet against GameStop shares (through short selling, i.e. a technique that involves borrowing shares of a company and selling those in the market, with a view that the price would decline and the shares can be later purchased at a lower cost), one app stood out as a weapon of choice: Robinhood, an American financial services company founded in 2013 and headquartered in California, with a sales pitch of no trading fees or account minimums. Traders from the WallStreetBets ("WSB") forum used the fee-free stock trading app and others (Interactive Brokers, Charles Schwab, TD Ameritrade, ...) to push shares of the beaten-down game retailer 18,600% higher over the past nine months (+2,440% over the past 4 weeks alone!), making many hedge funds scream in pain.

Traditional investors were scratching their heads at such dreamlike rally: Suddenly, the hunters (blood smelling, greedy large hedge fund managers) had become the hunted! Several short sellers were carried out of the trade; Most notably, Melvin Capital said that it had closed its short position and taken a cash injection from bigger friends - Citadel LLC & Point 72 Asset management - to repair the large hole in its balance sheet (that's what hedge fund friends are for 😊). Maplanelane Capital LLC, a New York hedge fund that started the year with about \$3.5 billion, was also down roughly 30% for the year through Wednesday, with its bearish GameStop position a significant driver of losses. And yet short interest in GameStop shares remained quite high, giving added confidence to buyers that they would be able to sell their shares to a desperate short seller and get out at a profit.

The popularity of the trade and the app were in full display this week, as GameStop updates became breaking news / headline stories globally while Robinhood jumped to the top spot in Apple's Store – notching a record 2.6 million daily active users. Here was an app that was greatly facilitating the job of the "*proletariat*" (working class) to take on the "*bourgeoisie*" (capitalists, globalists, ...) of Wall Streets. "*WSB feels like it's the working class versus the hedge funds. The poor versus the rich,*" Twitter user @Reddit Investors told Yahoo Finance on Wednesday morning. Louis Rossmann, an American IT repair technician and YouTube personality, agrees. "*There is a lot of pent-up aggravation at the financial services industry that has been brewing for the last 13 years,*" Rossmann told Yahoo Finance. The "*K-shaped recovery*" which mostly benefits the wealthy, is part of that aggravation, he added. "*When the pandemic occurred, you had trillions of dollars injected into the stock market, while normal regular people that were no longer allowed to work, went broke and bankrupt,*" Rossmann added.

Yesterday, however, Robinhood had fallen from favor with this new group of investors as it abruptly restricted users from purchasing shares of the electronics retailer (other trading platforms did the same too). In addition to GameStop stock, Robinhood also restricted certain transactions for other similarly touted stocks by the same sub-Reddit pager – including shares of AMC Theatres, Blackberry and Bed Bath & Beyond. “*We continuously monitor the markets and make changes where necessary,*” the company said in a blog post. “*In light of recent volatility, we are restricting transactions for certain securities to position closing only, including AMC, BB, BBBY, EXPR, GME, KOSS, NAKD and NOK. We also raised margin requirements for certain securities.*” Effectively, as many Robinhood users were logging in yesterday, they were informed they could no longer buy shares of GameStop but could still sell them, which would essentially lower the price. As a result, GameStop stock plunged roughly 44% on Thursday to \$193 a share versus a closing price of \$348 a share the day before.

The actions of the trading platforms sparked immediate backlash from lawmakers and political figures on both sides of the aisle. New York Attorney General Letitia James, a Democrat, tweeted late yesterday that her office would be looking into the situation. Representative Alexandria Ocasio-Cortez (AOC), D-NY - took a break from regular Trump/Republicans bashing – saying that the restrictions on GameStop stock were “*unacceptable.*” “*We now need to know more about @RobinhoodApp’s decision to block retail investors from purchasing stock while hedge funds are freely able to trade the stock as they see fit,*” she wrote on Twitter, adding that she would support a hearing “*if necessary.*” Tesla chief executive Elon Musk, who helped fan the flames of the initial rally, replied to AOC’s tweet with: “*Absolutely.*” Ted Cruz, R- Texas, later reposted AOC’s tweet with the comment: “*Fully Agree.*” Sen. Sherrod Brown, D-Ohio, the incoming Chair of the Senate Banking and Housing Committee, confirmed later Thursday that he planned to hold a hearing on the “*state of the stock market.*” “*People on Wall Street only care about the rules when they’re the ones getting hurt,*” Brown said in a statement. “*American workers have known for years that the Wall Street system is broken – they have been paying the price.*”

Overnight, Robinhood reversed course, saying it would “*allow limited buys of these securities*” on Friday (prompting GameStop shares to rise 80% in pre-market trading, last quoted at \$350 a share). This announcement comes on the back of news that the trading app has drawn down close to a billion dollars of its bank credit lines to ensure it has enough cash to clear trades, according to people with knowledge of the matter.

How Will the GameStop Game Stop?

Depending on who is still left short or long the stock at this point in time, any of the following scenarios is possible:

- ❖ The stock keeps rallying all the way up to \$1,000, as investors grow confident that the company has great potential to grow earnings and expand margins at an exponential rate, becoming the dominant player in the video game industry (à la Tesla’s stock explosion to the upside over the past year). In other words, investors look past today’s relatively modest results (the company isn’t projected to turn a profit before fiscal 2023!) and value the company based on stunning achievements they project for the future. This is quite hard to imagine, but again never say never!
- ❖ The stock keeps rallying all the way up to \$1,000, every hedge fund still sitting on short positions goes bankrupt, financial meltdown follows, the stock market shut for a period of time. Capitalism as we know it ends, ushering a new “golden” or “dark” age of global financial and capitalism reset.

- ❖ The stock keeps rallying over coming days/weeks (peaking well below \$1,000), then it crashes back down afterwards. That is usually how bubbles and speculative manias work (courtesy free money from central bankers and governments). The trick, then, is figuring out whether it still makes sense to purchase the stock at current elevated levels and/or deciding how high it will rally for a winning exit. Everyone on Reddit buying the stock right now is hoping to get out before it collapses, so if your plan is to sell it to them and their plan is to sell it to you, then good luck! Someone will surely be in big trouble at one point in time.

GameStop Saga's Real Lessons:

- ❖ Financial markets are rigged! Adapt to this reality or quit trading (my Personal Message Greeting on Bloomberg since 2009).
- ❖ Financial markets should have unbiased regulators closely looking for manipulators.
- ❖ Squeezing larger short (or long) positions has been a Wall Street blood sport for decades.
- ❖ Market bubbles are more or less easy to spot. The GameStop share price action surely qualifies for one. People usually choose not to pay attention until it is too late (the 1990s Dot-Com bubble / burst).
- ❖ Bursting of financial bubbles is inevitable and isn't always bad. The million-dollar question is whether monetary and fiscal policy should address bubbles as soon as they start developing or just react later to asset bubble bursts.
- ❖ Big and favored Wall Street names will always be bailed out (poor Lehman Brothers did not make the cut in 2008, nor did LTCM prior to that in 1998).
- ❖ Regulators will have to respond to this latest equity market fiasco. Any suggestion that they are defending hedge funds against retail investors would be disastrous.
- ❖ Online brokerage platforms' services should be better regulated (by now, it is quite clear how manipulative social media platforms can be). The issue of whether Robinhood and others really engaged in making trading feel more like a game, helping young individuals to get addicted to it, will also need to be addressed.

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