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MACROCOSM

GameStop: Reddit Where Credit is Due

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It's not a retail frenzy, a "stimulus" bubble or a systemic credit risk. It's just a correction.

We've resisted writing about the GameStop affair, in part because *we see it as a tempest in a teapot*, and in part because *everyone else is writing such silly stuff about it*, depending on their particular confirmation bias. It's the retail investor's "rage against the machine." It "echoes Occupy Wall Street." There are parallels to "a pro-Trump mob that stormed the U.S. Capitol." Facebook's censors fear "adult sexual exploitation" is involved. Senator Elizabeth Warren (D-MA) blames "the hedge funds, many of the giant corporations." Her usually ideological ally the *Washington Post* says hedge funds are "the good guys." It's a call-the-top sign of a "speculative frenzy" of retail investors, including a 10-year-old who made a 5,000% return. And supposedly it is the result of Covid-19 "stimulus" checks and too-easy-for-too-long Fed policy.

First and foremost, we've seen this kind of thing before. It is not unique to this time and place. It is, at heart, a classic short-squeeze, no different structurally than the VIX crisis of February 2018, when there wasn't much of an argument about market tops, retail frenzy or stimulus checks, and Fed policy was in the process of tightening (see "Inside the VIX Engine of Destruction" February 8, 2018). Then, as now, some hedge funds were caught short in what had seemed like a one-way trade, and dealers got sidewise managing gamma-risk. This time around there is the seemingly unique circumstance of *the catalytic presence of retail traders communicating with each other via Reddit*. But investors have profited by colluding to squeeze shorts forever -- Cornelius Vanderbilt and James Gould just didn't have Reddit (they didn't even have the telegraph).

- The supposed anti-hedge fund anger on Reddit is just a surface, it's just words – it doesn't matter to the analysis of market impact. Whatever the words, we don't believe that retail investors, 10-year-olds or otherwise, did this single-handedly. We have many hedge

Update to strategic view

US EQUITIES, US BONDS, OIL, FX, US MACRO: The GameStop affair is a tempest in a teapot, and an excuse for everyone to project their political and market biases. This is a classic short-squeeze, like the VIX blow-up in early 2018. The only difference is that this one was catalyzed by retail investors on Reddit. We don't believe they did it single-handedly, without opportunistic hedge funds and prop-desks piling on. We don't see retail participation here as classic evidence of a market top. Retail blow-offs are in over-loved momentum stocks – this is a sector-rotation into under-loved cyclicals given up for dead after the pandemic lockdowns. We can't know to what extent the recent round of "stimulus" payments fueled this. There is so far no specter of systemic credit risk here. Equities are in a long-overdue correction. It won't be long-lived: the usual risk indicia – the dollar, Treasury yields and credit spreads – haven't moved. Steady oil prices suggest no business cycle risk. We predict this will all be forgotten in a week.

[Strategy dashboard]

fund clients, and we can assure you that they and every prop-desk on Wall Street monitors Reddit bulletin boards and every other information medium, always looking for any catalyzing dynamic they can pile onto opportunistically. They have no scruples about squeezing their brethren, nor should they.

- For that matter, it's a sure bet that *some of the Reddit posts aren't made by retail investors at all, but hedge fund managers in masquerade*, pretending to hate other hedge fund managers, trying to get something spun up. If it wasn't that way to begin with, it absolutely has to be now.

Be that as it may, we don't see the retail element here as ipso facto evidence of a market top. To be sure, Joseph Kennedy famously said in 1928 that "You know it's time to sell when shoeshine boys give you stock tips. This bull market is over." Stocks appreciated 45% after he said that (before crashing). Imperfect timing aside, there's no doubt more than a little truth to it. *But it doesn't seem entirely relevant in this case.* We're not talking about 1920's shoeshine boys, but rather sophisticated modern hobbyists who very intentionally used Reddit as an organizing agent to "talk their book" and generate a flash-mob that would, collectively, give them the buying power to squeeze shorts in companies well known objectively to be heavily shorted.

- *If anything, this all strikes us as a salutary re-equilibration of market forces* that redresses, at least in part, an issue that many clients have complained to us about for over decade – that *algo-driven and high-frequency trading had shut the retail investor entirely out of the market*.

- We've seen real bubbles that sucked in retail investors. We remember 1999 and 2000 vividly, having experienced those years on-the-ground in Silicon Valley as CEO of a dot.com start-up, in fact one designed specifically to cater to the fascinations of retail investors. *That canonical blow-off top driven by retail hope and greed focused on momentum stocks that everyone loved and no one shorted.* Remember Tokyo Joe and *The Gilder Technology Report*? *This time couldn't be more different, with the focus instead on given-up-for-dead stocks that everyone shorts.*
- Indeed, we could almost see this as an odd manifestation of the sector rotation we've been expecting for months – not so much

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[About us]

away from "growth" and toward "value," but away from stay-at-home stocks that have profited from the 2020 lockdowns and toward in-person cyclicals that have been punished by them (GameStop is an in-person retail company, as are some others that have gotten caught up in last week's volatility, such as AMC Entertainment).

- Perhaps this is only a small confirmation, but it is the case that through Friday the S&P 500 Value Index corrected 3.6% from last week's high, while a cap-weighted portfolio of the five FAANG stocks corrected 6.6%.
- *Surely some of that is the chill that any unexpected market volatility imparts – it makes investors question market leadership, especially the most richly valued members of it.*
- *Did the latest round of $600 "stimulus" checks make it all possible?* It's a good story, especially for those who are looking for evidence that so much "stimulus" has been unnecessary (something with which we don't disagree, by the way; see "Do We Need More Stimulus?" December 14, 2020). *But who can say with any analytic rigor what role the payments really played in the GameStop affair, if any?* Fed chair Jerome Powell seems to think they might have had a role – but maybe that's just to deflect any blame directed at monetary policy (we fully agree there is no fault *there*; see "On the July FOMC" July 29, 2020).
- $600 isn't a lot of money. But enough $600 option trades, we suppose, could aggregate up into a market-moving force. But if that's true, that's not quite the usual formula for a retail-driven market top. It's not like Reddit traders are throwing caution to the winds and dipping into the tips painfully accumulated over years in their shoeshine boxes – they're playing with mad-money they got out of the blue several weeks ago.

None of that is to say that this equity market isn't due for a correction. We've been warning about a correction for the better part of a month, and it took the GameStop affair to finally make it happen (see "On Georgia" January 6, 2021 and "The Coming Trump Energy Vacuum" January 19). Or at least the present correction has coincided with the GameStop affair, though the cause-and-effect link is not certain.

- *What about the GameStop affair ought to drive a correction, though?*

- Anytime hedge funds and derivatives dealers suffer big losses, and anytime retail trading platforms face capital constraints, there is the specter of systemic credit risk in the banking system. *That doesn't seem to be showing up in markets, though. While the S&P 500 has corrected almost 5% over three trading sessions, the usual indicia of systemic risk – the dollar, Treasury yields and credit spreads – have hardly budged* (the 10-year yield has actually backed up slightly over the same three days). And oil prices have barely moved, suggesting no business-cycle risk.
- The narrative that fiscal and monetary policy are to blame says, in essence, that there is too much liquidity in the financial system. If so, that would tend to cut against a fear of a sudden systemic credit risk event, the best palliative for which is liquidity.
- Also, it is in the nature of events like the GameStop affair to be self-regulating. People learn from experience. Shorts will trim their positions before they become the next squeeze victim. Reddit traders will learn that the stocks they buy also have to be sold; the collective market power that drives stocks up when they all buy at the same time will drive them back down when they all sell at the same time, and suddenly this game won't look so easy to the Reddit crowd, or the hedge funds who pile on.
- Finally – and this may be our own confirmation bias at work – we can't help but thinking there is something valuable in the bipartisan swell of populism that has brought Alexandria Ocasio-Cortez (D-NY14) and Ted Cruz (R-TX) together in common cause on Twitter, to defend retail investors against arbitrary restrictions of their trading. *Maybe politicians will realize that if it is an "unacceptable" transgression against liberty to prevent retail trading in GameStop in a vain attempt to rein in market volatility, it is also a transgression to prevent commerce at GameStop's retail stores in a vain attempt to rein in Covid-19.*

- Our guess is that in a week this will all be forgotten, and people will have to find some other narrative to promote their political preconceptions, or their long-thwarted claims that this market is a doomed speculative frenzy.

Bottom line

The GameStop affair is a tempest in a teapot, and an excuse for everyone to project their political and market biases. This is a classic short-squeeze, like the VIX blow-up in early 2018. The only difference is that this one was catalyzed by retail investors on Reddit. We don't believe they did it single-handedly, without opportunistic hedge funds and prop-desks piling on. We don't see retail participation here as classic evidence of a market top. Retail blow-offs are in over-loved momentum stocks – this is a sector-rotation into under-loved cyclicals given up for dead after the pandemic lockdowns. We can't know to what extent the recent round of "stimulus" payments fueled this. There is so far no specter of systemic credit risk here. Equities are in a long-overdue correction. It won't be long-lived: the usual risk indicia – the dollar, Treasury yields and credit spreads – haven't moved. Steady oil prices suggest no business cycle risk. We predict this will all be forgotten in a week.