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Shedding Light on the GameStop Mania

You can't go anywhere right now without hearing about GameStop, Reddit, r/WallStreetBets, and big returns. This story has made it out of financial circles and has become "news" news. Saturday Night Live even did a skit including the Gamestop hysteria. So while the internet is abuzz and investors have questions we thought we could help shed some light on the situation.

Reddit and r/WallStreetBets

Reddit is a social media platform and application where groups of like-minded individuals can start chat rooms and post threads discussing whatever they like. One such popular group is called r/WallStreetBets. There are now over 6mm members of this group but many of the more prominent members have many followers on outside media as well like YouTube Channels and post trade ideas on various stocks. These traders often work together, sharing ideas and trying to convince other traders to join them. Several of the more prominent proponents of the GameStop trade point out that many large hedge funds have short positions on the company; and that by pushing the stock higher, it would be a way of punishing the "suits" or "old guard" as they are often referred to in social media. This has fueled a sort of David vs Goliath attitude by many traders.

GameStop Short Squeeze

Looking at the GameStop example since that is the most popular topic of conversation right now, people keep repeating phrases like short interest, short squeeze, and even gamma squeeze. **These topics can get highly technical but in summary, all three can create instances of short-term increased buying of a specific stock**; and if we remember Economics 101, increased demand without increased supply causes prices to go up—in this case, a stock price. For the technical jargon: short interest is the amount of a company's stock that investors are short (betting the shares will go down in value by selling shares they don't own). A short squeeze occurs when the price of the stock goes up, which creates a margin call for short-sellers which then have to purchase shares to cover their short position and pay back the margin they took on by selling shares they don't own. And a gamma squeeze occurs when investors buy short-dated call options and the dealers who sell them have to hedge their position by purchasing stock. As the stock goes higher, dealers have to purchase more stock to stay "delta hedged". As you can see all three cause short-term increases in demand for shares.

Trading Strategy vs. Investment Strategy

So traders on this platform convinced others to join their campaign to push a specific stock issue higher by buying shares or options on a specific company. **An important distinction to make here is that this is a trading strategy, not an investment strategy**. The biggest difference being the time frame. Make no mistake, most of these traders are interested in hopefully making a large financial gain on a short term dislocation between price and fundamental value of this stock. A company's value (stock price) should be tied to its business success or lack thereof. But we think most traders, or even those within the company, would have a hard time explaining why GameStop the company is worth almost two hundred times what it was worth just a few short weeks ago! Especially considering that most game players are now downloading games – which is one reason that many professional investors are short shares on the company. Once this short-term inflow of buyers sells, short interest increases or regulators step in we're likely to see a reversion lower in the stock price. No one can be sure when this comes.

In the meantime, **the stock will almost assuredly stay very volatile and could go up massively or down massively**. As long-term investors, we have no interest in trading these types of speculative investments. We will stick to our knitting, analyzing individual companies to be sure that management teams are good, balance sheets are strong, and free cash flow is positive for owners of a stock.