CONWAY• JARVIS LLC

Investment Outlook

Volume 30 Issue 4.4 January 29, 2021

Update

The Retail Trade Scores a Rare Win on Wall Street

The Retail Trade, comprised of individual investors, has usually come out on the short end when competing with the Big Money on Wall Street. The Big Money is defined as the major investment firms, banks, and hedge funds that employ financial engineering, high-speed trading, and algorithmic science to move the markets in a desired direction. As investors for whom fundamentals matter, we've frequently lamented the inexorable transformation of the stock market from a capital formation entity favoring long-term investors to a casino where the House (Big Money) usually comes out ahead in short-term trading. The tables were turned briefly this week and the financial media could talk about nothing else.

This week The Little Guy, the retail investor, delivered a whupping to a number of hedge funds and institutional investors. At least that's how it's being portrayed by the media. In reality, a group of retail investors utilizing Robinhood, Reddit, YouTube, and other social media and technology platforms seized on a unique investment opportunity. Several large hedge funds and short-sellers had sold roughly 140% of the outstanding shares of GameStop, a distressed bricks and mortar retailer of video game merchandise. The deficit of shares available to cover the aggregate of short positions triggered a meteoric rise in the stock price. When other professional investors joined the fray, it created a classic "short squeeze" and an existential crisis for some hedge funds. Few tears are being shed for Big Money.

We're currently only interested spectators, but this week's spike in market volatility raises our concern that there could be consequences extending from these hedge funds to the broader market and the financial system. How were these firms allowed to short far more shares than existed? The last time we looked, naked short selling was prohibited. It's simple: If you can't borrow the shares, you can't sell short. We suspect options market activity exacerbated the oversold condition. Much like 2008, a gap in enforcement of the regulations *between* exchanges created conditions for firms to underestimate the risk associated with positions on their books. The short squeeze could have ramifications for the broader stock market in the short run as some firms may be forced to sell stocks to cover their losses. That could be the catalyst for a brief market consolidation or correction. A greater concern is whether the fallout could extend to banks and brokers that have been deemed "Too Big to Fail". There's currently no evidence of that.

There's no doubt we can count on those in Washington to form commissions, and air investigatory hearings while demonstrating their outrage at those who manipulate the markets. This isn't a case of market manipulation but rather a failure of oversight and enforcement. The current laws and regulations are sufficient and already in place. What's needed is a cohesive enforcement strategy that *connects* regulatory agencies as they monitor *any* entity in *any* market linked to the investing public. Eliminating the gaps and dark shadows of the regulatory matrix and achieving competent enforcement should be the first order of business. Chances of that happening? If what we saw from politicians yesterday in the media is any indication, Slim and None. Stay tuned.

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