GLOBAL BANKING & Finance review

GameStop: How events unfolded and the next chapter

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GameStop is a bricks and mortar video gaming retailer which launched in 1984. It has stores in malls around the US and, for a time, was very successful. But as shopping habits changed, it faileda not only to anticipate these changes, but also to subsequently alter course and build a strong online presence. That's the main reason that several Wall Street hedge funds decided to target the company by borrowing shares in GameStop and then selling them short, betting that the company would eventually go out of business. This would mean stocks plummeting to zero, and as these funds were selling between about $10 and $20 per share, they would make a decent profit. This ploy is nothing new, particularly since the big shift in retailing from bricks and mortar to e-commerce. But the search for vulnerable businesses accelerated after lockdowns were introduced last year due to the coronavirus pandemic.

But there were Wall Street players and other traders prepared to take the other side of this bet having studied the company's accounts. In the twelve months between August 2019 and August 2020, the share price of GameStop hovered between $3 and $6. They thought this was irresistibly cheap given the company's assets, so buyers came in and the stock broke out of this range to spend the next few months butting up against resistance around $20, where most of the short-selling took place. And this is where the GameStop saga started to unfold.

Reddit's WallStreetBets steps in

Those on the bullish side believed that even at $20, shares in GameStop were undervalued. They were convinced the company was worth three times as much. One of these traders was a prominent contributor to the 'wallstreetbets' community named Keith Gill, also known as 'Roaring Kitty'. He has lots of followers interested in trying out his investment hypotheses. Not only did Mr Gill and others see value in GameStop, but they also noticed the large 'short interest' in the stock by Wall Street firms. There was little doubt that GameStop was vulnerable thanks to its lacklustre online presence paired with the ravages inflicted by the political reaction to the coronavirus pandemic. But short sellers also have weaknesses to exploit. After all, a stock can only fall to zero, while in theory there's no limit to its upside. Incredible as it sounds, the overall short position on GameStop was larger than the shares in existence thanks to derivative trades. That meant further instability. Should a pack of determined buyers get together to take advantage of this fact, all hell could break loose with the right catalyst. And that's exactly what happened.

In early January, GameStop appointed three new executives to its board. One of these executives was Ryan Cohen, the founder and former CEO of e-commerce business Chewy Inc. The other two were colleagues of his. This raised hopes that GameStop was serious in addressing weaknesses in its online offering. Once the potential impact of the news filtered through, the stock jumped from around $20 to just below $40 in a single day. But it didn't stop there. A little over two weeks later, following a cryptic tweet from Elon Musk, the stock soared to $483 before crashing back down to little more than $100 on the same day. Unusually, most of the speculators buying the stock were the retail crowd, with many on the 'wallstreetbets' subreddit, and dealing on no-commission trading apps like Robinhood. While Wall Street hedge funds, notably Melvin Capital and Citron Capital, were on the other side of the trade.

Then the followers and contributors on wallstreetbets targeted other stocks with a large short interest, including AMC Entertainment, Blackberry, Nokia, and Bed Bath & Beyond. Then it was silver and pot stocks. But it didn't take long before conflict broke out. First there were accusations that Reddit had enabled market manipulation to drive GameStop higher and bust the hedge funds. Then without warning, Robinhood and several other retail-focused brokers set trading restrictions on GameStop and many other shorted stocks. Retail traders could sell and close existing positions but were unable to open new ones. This caused outrage, particularly as Wall Street firms were able to deal unhindered. It also meant the end of the short squeeze as buying momentum in GameStop had been quashed.

Regulators were called upon to take action

Regulators such as the Securities and Exchange Commission (SEC) and the Commodities and Futures Trading Commission (CFTC) were called on to review events around the GameStop short squeeze. There was even talk of the US Federal Reserve and the US Treasury getting involved. It's possible there will be an investigation of some sorts. But what would such an investigation focus on? Accusations of market manipulation? The involvement of social media in communicating trading ideas? Short-selling? Retail involvement in stock markets? These are all possibilities. But as far as the US House Financial Services Committee is concerned, there are far more problematic issues and Wall Street would probably prefer to see these swept under the carpet.

The first hearing and what it tells us

On Thursday 18th January, the committee convened a hearing. As witnesses they called:

- Robinhood CEO, Vlad Tenev.
- Ken Griffin, founder of Citadel Securities, through which Robinhood processes its customers' orders.
- Gabe Plotkin, founder of hedge fund Melvin Capital, one of the big losers from the short-squeeze and also the beneficiary of a rescue bailout from Citadel.
- Jennifer Schulp, expert in financial regulation at the Cato Institute.
- Steve Huffman, the CEO of Reddit.
- Keith Gill, aka 'Roaring Kitty'.

It soon became apparent that Congress wasn't interested in Reddit or Mr Gill, who each provided an impressive five minutes of testimony stating their positions clearly and confidently. They both received backing from Ms Schulp, who insisted that markets had been orderly overall so there was no need whatsoever to consider retail traders an issue. Instead, it was the Wall Street professionals who were the targets. Their testimony was poor and they sounded evasive. Indeed, Mr Tenev received quite a roasting from just about everyone and the cosy relationship between Robinhood and Citadel was highlighted, as was Robinhood's decision to restrict its customers' trading.

So, three cheers for the House Financial Services Committee, and well-done Mr Huffman and Ms Schulp. But we should also offer a big round of applause and a box of catnip for Roaring Kitty. This may not be the end of the enquiry but it certainly sets the parameters. Any new investigation will have to focus on Wall Street and how it runs its affairs. Then we'll see if Vlad's Robinhood turns out to be the scapegoat once again.